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SUPREME COURT, U.S.
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Nos. 06-1457 & 06-1462

IN THE

Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC.,
Petitioner,

AND

CALPINE ENERGY SERVICES, L.P.,
AMERICAN ELECTRIC POWER SERVICE CORP.
AND
ALLEGHENY ENERGY SUPPLY CO., LLC,
Petitioners

v.

PUBLIC UTILITY DISTRICT NO. 1
OF SNOHOMISH COUNTY WASHINGTON, *et al.*,
AND
FEDERAL ENERGY REGULATORY COMMISSION,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

JOINT APPENDIX VOLUME THREE

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Petition for Writ of Certiorari Filed May 3, 2007
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APPENDIX P

103 FERC ¶ 61,353

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and
Nora Mead Brownell.

Nevada Power Company and
Sierra Pacific Power Company

Docket Nos. EL02-28-000
EL02-28-002
v. EL02-33-000
EL02-33-002
EL02-38-000
Enron Power EL02-38-002
Marketing, Inc.
El Paso Merchant Energy
American Electric Power Services, Corp.

Nevada Power Company

Docket Nos. EL02-29-000
EL02-29-002
EL02-30-000
EL02-30-002
v. EL02-31-000
EL02-31-002

	EL02-32-000
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Capital Group	EL02-34-000
Calpine Energy Services	EL02-34-002
Mirant Americas	EL02-39-000
Energy Marketing, L.P.	EL02-39-002
Reliant Energy Services	
BP Energy Company	
Allegheny Energy Supply Company, L.L.C.	
Southern California Water Company	

	Docket Nos. EL02-43-000
v.	EL02-43-002

Mirant Americas
Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

	Docket Nos. EL02-56-000
v.	EL02-56-002

Morgan Stanley Capital Group, Inc.

(Consolidated)

ORDER ON INITIAL DECISION,
REHEARING REQUESTS, AND MOTIONS

(Issued June 26, 2003)

1. This case is before the Commission on

exceptions to an Initial Decision[1] issued in this proceeding. This proceeding addresses complaints filed by Nevada Power Company and Sierra Pacific Power Company (Nevada Power and Sierra Pacific or collectively, Nevada Companies), Southern California Water Company (SCWC), and Public Utility District No. 1 Snohomish County, Washington (Snohomish). The complaints allege that dysfunctions in the California electricity spot markets caused forward contracts negotiated in the bilateral markets in California, Washington and Nevada, and entered into pursuant to the Western Systems Power Pool (WSPP) Agreement during the period November 1, 2000 through June 20, 2001, to be unjust and unreasonable. The complaints seek a remedy of contract modification.

2. In the order issued on April 11, 2002,[2] the Commission set the instant complaints for hearing. After an evidentiary hearing, the Administrative Law Judge (ALJ) concluded that the applicable standard of review intended by the parties for the contracts at issue here is the "public interest" standard[3] and that the Complainants have failed to meet their burden under this standard of review.

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[1] Nevada Power Co. and Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, 101 F.E.R.C. ¶ 63,031 (2002) (Initial Decision).

[2] Nevada Power Co. and Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, 99 F.E.R.C. ¶ 61,047, *order on reh'g*, 100 F.E.R.C. ¶ 61,273 (2002), *reh'g pending*. (April 11 Order).

[3] *See* United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) (Mobile); FPC v. Sierra Pac. Power, 350 U.S. 348 (1956) (Sierra); and United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div., 358 U.S. 103 (1958).

3. In this order, we affirm the ALJ's decision denying the complaints for the reasons stated below. In denying the instant complaints, we took into consideration the evidentiary record developed in this proceeding, findings of the Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report), and evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95,*et al.*[4]

4. Specifically, we affirm the ALJ's findings that the applicable standard of review for the contracts at issue here is the "public interest" standard and that the Complainants have failed to meet their burden of proof under this standard of review.

5. Before discussing the specific facts of the case before us, it is important to understand the historical context in which the "public interest" standard has been applied by the courts, and the legal parameters within which the Commission must address requests for contract reformation. The "public interest" standard of review was first introduced by the U.S. Supreme Court in the 1956 *Mobile* case[5] and the concurrently decided *Sierra* case.[6] The U.S. Supreme Court held that, in order to justify modification of its contract, the seller in that

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[4] San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv., 101 F.E.R.C. ¶ 61,186 (2002), *order on clarification and reh'g*, 102 F.E.R.C. ¶ 61,164 (2003).

[5] United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956).

[6] *See* FPC v. Sierra Pac. Power, 350 U.S. 348 (1956).

case had to show that the contract rate was so low that it was contrary to the public interest. In the *Mobile* and *Sierra* decisions, the Court sought to mesh the respect for the sanctity of contracts under the Federal Power Act (FPA)[7] and Natural Gas Act[8] with the traditional scheme of regulation under those statutes. The Court held that, where the utility and its customer contracted for a particular rate and did not reserve for the seller the right to unilaterally propose a rate change, the utility cannot unilaterally (i.e., without the customer's consent) file a new rate under section 205 of the FPA[9] to supersede the agreed-upon rate. The Court also ruled that the Commission's power under Section 206 of the FPA[10] to alter the existing contract rate, after its acceptance by the Commission, is limited.[11]

6. In the *Sierra* decision, the Court gave examples of factors that would meet the "public interest" standard and allow the selling utility to modify its contract. The selling utility was required to demonstrate that "the rate is so low as to adversely affect the public interest -- as where it might impair the financial ability of a public utility to continue service, cast upon other [customers] an excessive burden, or be unduly discriminatory."[12]

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7 16 U.S.C. §§ 796 *et seq.* (2000).

8 15 U.S.C. §§ 717 *et seq.* (2000).

9 16 U.S.C. § 824d (2000).

10 16 U.S.C. § 824e (2000).

11 Boston Edison Co. v. F.E.R.C., 233 F.3d 60, 64-65 (2000) (citing Sierra, 350 U.S. at 352-55; accord Mobile, 350 U.S. at 347).

12 *See* Sierra at 355.

7. Both *Mobile* and *Sierra* addressed seller challenges to contract rates alleged to be too low. In later cases, the *Mobile-Sierra* doctrine was applied to contracts containing rates that allegedly were too high.[13] The *Mobile* and *Sierra* cases were decided in a cost-based rate regime and consequently dealt with changes proposed to contracts that were already on file with the Commission. The application of the *Mobile-Sierra* doctrine was later extended to contracts that were not on file with the Commission.[14]

8. In a more recent case involving a long-term, fixed-rate contract, the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest'] standard."[15] In *PEPCO*, the court also noted that the purchaser seeking a lower rate failed to "offer any evidence (beyond speculation) that the only potential non-parties here, its ratepayers, were adversely affected by the existing rates; it did not, for example, even attempt to show how much if any of the rate disparity was passed on to PEPCO

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[13] *See, e.g.*, Pub. Serv. Comm'n of N.Y. v. FPC, 543 F.2d 757, 798 (D.C. Cir. 1974).

[14] *See, e.g.*, Richmond Power & Light v. FPC, 481 F.2d 490, 493 (D.C. Cir. 1973) (holding that "the contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."). Lansdale, Pa. v. FPC, 494 F.2d 1104, 1112 (D.C. Cir. 1974).

[15] *See* Potomac Elec. Power Co. v. F.E.R.C., 210 F.3d 403, 404 (D.C. Cir. 2000).

ratepayers rather than borne by the utility itself."[16] While PEPCO claimed an excessive burden on its customers and discriminatory impact from the disparity between the contract rates and the OATT rate charged by the same transmission provider, the court said that "other than pointing out that the contract rate is twice [Allegheny's] OATT rate, [PEPCO] has presented no evidence regarding how the contract rates are unduly discriminatory or excessively burdensome on PEPCO ratepayers."[17] The court noted the Commission's precedent which holds that "the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to the public interest."[18]

9. Based on our review of the evidence and the totality of circumstances, we conclude that the Complainants have failed to meet their burden of proof under the "public interest" standard, as defined in past cases. We find that the challenged contracts are not contrary to the public interest because the Complainants have failed to demonstrate that the contracts in question caused financial distress for the Complainants so as to

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[16] *Id.* at 408.

[17] *Id.* at 409.

[18] *See, e.g.*, Gulf States Util. Co. v. S. Co. Serv., Opinion No. 300, 43 F.E.R.C. ¶ 61,003, at 61,016, *reh'g denied*, Opinion No. 300-A, 43 F.E.R.C. ¶ 61,394 (1988), *aff'd sub nom.* Gulf States Util. Co. v. FERC, 886 F.2d 442 (1989); *accord* Soyland Power Coop. v. Central Ill. Pub. Serv. Co., 51 F.E.R.C. ¶ 61,004, at 61,014-15, *reh'g dismissed as moot*, 52 F.E.R.C. ¶ 61,149 (1990); Pub. Serv. Co. of N.M., 43 F.E.R.C. ¶ 61,469, at 62,152, *reh'g denied*, 45 F.E.R.C. ¶ 61,034 (1988), *aff'd sub nom.* San Diego Gas & Elec. Co. v. FERC, 904 F.2d 727 (D.C. Cir. 1990).

threaten their ability to continue service, that the contracts cast an excessive burden on their customers, that the contracts were unduly discriminatory to the detriment of other customers that are not parties to this proceeding, or that any other factors on this record demonstrate that the contracts are contrary to the public interest. At the time of contract execution, other alternatives were available to the Complainants; however, they chose to enter into the contracts in question, accepting market risks. Complainants benefitted from resales of the energy purchased under these contracts during the relevant period; however, after the drop in prices in mid-2001, Complainants became dissatisfied with their bargains and sought contract modification. The law is quite clear on that point. The fact that a contract becomes uneconomic over time does not render it contrary to the public interest. We, therefore, deny the instant complaints.

10. In addition, we deny requests for rehearing of an order on rehearing, as discussed below. We also address certain procedural motions filed by Snohomish and SCWC.

11. This order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the *Mobile-Sierra* doctrine.

I. Background

12. On July 26, 2000, the Commission issued an order initiating an investigation of the conditions of bulk power markets in various regions of the

country.[19] On August 2, 2000, San Diego Gas & Electric Company filed a complaint, requesting that the Commission impose a $250 price cap for sales into the California Independent System Operator (ISO) and Power Exchange (PX) spot markets. The Commission denied the request in an order issued on August 23, 2000.[20] In that order, the Commission instituted hearing procedures to investigate the justness and reasonableness of the rates of public utility sellers into the California ISO and PX markets. The hearing was held in abeyance pending completion of the Commission Staff fact-finding investigation of the conditions of bulk power markets, which was completed in October 2000.

13. On November 1, 2000, the Commission issued an order proposing measures to address the dysfunctions in the California market and remedy the problems identified by the Staff investigation.[21] The Commission specifically identified the following rules and regulatory policies as flawed: the California Public Utilities Commission's (CPUC) requirement that the three California Investor-Owned Utilities (IOUs) buy and sell all their energy needs through the PX; the CPUC restrictions on the IOUs' ability to contract forward; the lack of retail demand responsiveness; and underscheduling due to the ISO's replacement reserves policies.[22] To correct the above identified market design problems, the

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[19] Order Directing Staff Investigation, 92 F.E.R.C. ¶ 61,160 (2000).

[20] San Diego Gas & Elec. Co., 92 F.E.R.C. ¶ 61,172 (2000).

[21] San Diego Gas & Elec. Co., 93 F.E.R.C. ¶ 61,121 (2000).

[22] *Id.* at 61,354-5.

Commission proposed, among other things, elimination of the requirement that the California IOUs sell all their generation into and buy all their requirements from the PX.

14. On December 15, 2000, the Commission issued an order[23] adopting, among other things, a benchmark price to provide guidance for assessing the prices of long-term electric supply contracts;[24] and market monitoring and price mitigation for the ISO and PX spot markets, including a $150 per MW price breakpoint.

15. Subsequent orders issued on April 26, 2001[25] and June 19, 2001 [26] adopted further market monitoring and mitigation measures for the California markets, and extended those measures to all Western markets.

16. To put the contracts at issue in this case in context, the Nevada Companies' contracts were executed between November 2000 to June 2001; the Snohomish contract was executed on January 26, 2001; and the SCWC contract was executed on March 19, 2001. During the relevant period the Complainants entered into a large number of

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[23] San Diego Gas & Elec. v. Sellers of Energy, 93 F.E.R.C. ¶ 61,294 (2000).

[24] The benchmark for five year contracts for supply around-the-clock was set at $74/MWh. *Id.* at 61,994.

[25] San Diego Gas & Elec. Co., 95 F.E.R.C. ¶ 61,115 (2001) (April 26 Order).

[26] San Diego Gas & Elec. Co., 95 F.E.R.C. ¶ 61,418 (2001) (June 19 Order).

contracts for purchase as well as for sale of energy; however, out of all these contracts the Complainants seek to modify only a relatively small number of contracts included in the instant complaints.

17. In December 2001, Nevada Companies filed separate complaints against the following entities: Duke Energy Trading and Marketing, L.L.C. (Duke), Morgan Stanley Capital Group Inc. (Morgan Stanley), Calpine Energy Services, L.P. (Calpine), Mirant Americas Energy Marketing, L.P. (Mirant), Reliant Energy Services, Inc. (Reliant), El Paso Merchant Energy, L.P. (El Paso), BP Energy Company (BP), American Electric Power Service Corporation (AEP), Enron Power Marketing Inc. (Enron), and Allegheny Energy Supply Company, L.L.C. (Allegheny). SCWC filed a complaint against Mirant. In February 2002, Snohomish filed a complaint against Morgan Stanley. The Nevada Companies and SCWC argued that the dysfunctions in the ISO and PX spot markets caused long-term contracts negotiated in California, Washington, and Nevada to be unjust and unreasonable and, consequently, requested modification of their contracts. Snohomish argued that the term of its contract and the Collateral Annex[27] are unjust and unreasonable. Unlike Nevada Companies and SCWC, Snohomish requested modification of the contract term, not the contract rate.

18. On January 10, 2002, Nevada Companies filed

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[27] The Collateral Annex sets forth the conditions under which Snohomish is required to provide collateral, as well as the conditions under which Morgan Stanley will release such collateral.

a notice of withdrawal with prejudice of complaint against Duke, explaining that Nevada Companies and Duke reached an agreement to modify their contracts, effective June 4, 2002.

19. On April 11, 2002, the Commission issued an order setting the instant complaints for a trial-type evidentiary hearing. In the April 11 Order, the Commission instructed the ALJ to examine the following issues: (1) whether the challenged contracts should be reviewed under the "just and reasonable" standard or the more stringent "public interest" standard of review; and (2) whether the dysfunctional California ISO and PX spot markets adversely affected Western long-term bilateral markets, and if so, whether contract modification is warranted.

20. The hearing on these issues was held from October 7-24, 2002. The Initial Decision was issued on December 19, 2002. In the Initial Decision, the ALJ found that the *Mobile-Sierra* "public interest" standard of review applies to the contracts at issue. Furthermore, the ALJ concluded that Complainants failed to satisfy their burden of proof to justify contract modification under the "public interest" standard. The following parties filed briefs on and opposing exceptions to the Initial Decision: Nevada Companies, Snohomish, SCWC, the Commission's Trial Staff (Staff), Mirant, Morgan Stanley, Public Utilities Commission of Nevada (PUCN), Allegheny, Enron, AEP, BP, Calpine, El Paso, and Reliant.

21. On November 20, 2002, the Commission issued an order allowing parties in the Docket No. EL00-95, *et al.* proceeding to adduce evidence that

was either indicative or counter-indicative of market manipulation that may have occurred during the California energy crisis of 2000-2001 (100-Day Discovery Proceeding).[28] The submission of evidence in the 100-Day Discovery Proceeding was completed on March 20, 2003.

22. On March 26, 2003, the Commission released the Staff Report. The Staff Report, among other things, asserted that many spot market trading strategies undertaken by certain sellers were in violation of anti-gaming provisions of the Commission-approved tariffs for the California ISO and PX. Upon Staff's recommendation, the Commission issued certain "show cause" orders requiring the named market participants to respond to market manipulation allegations of the Staff Report. Additionally, the Staff Report addressed the issue of whether the dysfunctional spot market had an impact on the forward prices reflected in long-term power supply contracts. The Staff Report analysis found that spot prices influenced forward prices negotiated during the January 1, 2000 through June 21, 2001 crisis period and that the influence was the greatest for contracts with one to two years terms.

23. Subsequent to release of the Staff Report, Complainants requested an opportunity to have oral argument before the full Commission. On April 14, 2003, the Commission granted this request. The oral argument took place on April 23, 2003.

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[28] *See supra* n.4.

II. Issues for Discussion

1. Applicable Standard of Review

24. In the April 11 Order, the Commission set for hearing the issue of whether the applicable standard of review for the Complainants to prevail is that a challenged contract was contrary to the public interest, or that the contract was not just and reasonable. The Commission determined that for all but one of the contracts at issue here, Section 6.1 of the umbrella WSPP Agreement [29] was the only specific contractual provision which may affect parties' rights to make changes to contracts entered into under the WSPP Agreement. The Commission noted that this provision addressed sellers' rights under Section 205 of the FPA, not buyers' FPA Section 206 rights, to modify rates affecting transactions under the WSPP Agreement.

25. In the April 11 Order, the Commission also determined that one of the contracts at issue, specifically the contract between Snohomish and Morgan Stanley, includes a separate provision, not contained in the umbrella WSPP Agreement, which addresses both FPA Section 205 rights and FPA

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[29] Section 6.1 of the WSPP Agreement states in part as follows: "Nothing contained herein shall be construed as affecting in any way the rights of the Parties to jointly make application to F.E.R.C. for a change in the rates and charges, classification, service, terms, or conditions affecting WSPP transactions under Section 205 of the Federal Power Act and pursuant to F.E.R.C. rules and regulations promulgated thereunder..."

Section 206 rights. [30] Initially, the issue of the applicable standard of review for this contract was also set for hearing. On rehearing, however, the Commission ruled that Snohomish must satisfy the "public interest" standard to justify modification of its contract with Morgan Stanley. [31] Snohomish requests rehearing of that determination.

26. Also, on rehearing, the Commission specified that the evidentiary hearing was established to interpret Section 6.1 of the WSPP Agreement and to ascertain the intent of the parties at the time the contracts in question were signed.[32]

A. Initial Decision

27. The ALJ ruled that the applicable standard of review for the instant complaints is the "public interest" standard. In particular, the ALJ found that each contract at issue consists of a Confirmation Agreement, the WSPP Agreement and any amendments, which together form a single, integrated document. [33] The ALJ also found that

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[30] Section 39B of the Confirmation Agreement between Snohomish and Morgan Stanley states: "The rates for service specified in this Agreement shall remain in effect for the term of this Agreement and shall not be subject to change through application to F.E.R.C. pursuant to the provisions of Section 205 or 206 of the Federal Power Act."

[31] *See* Nevada Power Co. and Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, 100 F.E.R.C. ¶ 61,273, at 62,047-48 (2002), reh'g pending (Rehearing Order).

[32] *Id.* at 62,047.

[33] The ALJ relied on Sections 2.2, 26 and 35 of the WSPP Agreement. *See* Initial Decision at 65,274.

Section 6.1 of the WSPP Agreement allows parties to jointly seek modification of the rates, terms and conditions of the contracts under Section 205 of the FPA; however, the cited section does not have any language regarding the parties' FPA Section 206 rights. [34] Accordingly, the ALJ concluded that pursuant to court and Commission precedent,[35] in the absence of clear contractual language allowing unilateral contract modifications under Section 206, Complainants must meet the "public interest" standard of review.[36]

28. In addition, the ALJ found that nothing in Section 6.1 of the WSPP Agreement, nor in the underlying Confirmation Agreements, suggests that the contracting parties intended to give unilateral authority to modify the contracts under Section 206 of the FPA. The drafters of the WSPP Agreement have envisioned a possibility of a joint application to the Commission to change rates, terms and conditions of the WSPP Agreement and transactions entered into thereunder pursuant to Section 205 of the FPA and they could easily have added language to allow other ways of making changes to the WSPP Agreement. Thus, the ALJ concluded that the only rational interpretation of Section 6.1 of the WSPP Agreement would be that it precluded unilateral

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[34] *Id.*

[35] The ALJ cited to Texaco Inc. v. FERC, 148 F. 3d 1091, 1096 (D.C. Cir. 1998); Boston Edison Co. v. FERC, 233 F.3d 60 (1st Cir. 2000); San Diego Gas & Elec. Co. v. Pub. Serv. Co. of N.M., 91 F.E.R.C. ¶ 61,233 at 61,851 (2000); and Metro. Co. v. FERC, 595 F.2d 851, 855 (D.C. Cir. 1979). *Id.* at 65,275.

[36] *Id.*

contract modification.[37]

29. The ALJ also considered the parties' intent at the time the contracts were signed. It was found that the evidence submitted in this case did not support Complainants' allegations concerning intent and that Complainants' witnesses' testimony in this regard was not credible.[38] The ALJ also found that substantial evidence supports Respondents' arguments concerning this issue. In particular, Respondents provided corroborated evidence that the parties' Section 206 rights were never a subject for consideration during negotiations.[39]

30. Furthermore, the ALJ disagreed with the Complainants' contention that the *Mobile-Sierra* doctrine does not apply to the facts at issue here. The ALJ determined that the *Mobile-Sierra* doctrine does not distinguish contracts based on the length of the contracts, whether the rates are low or high, or whether the complaint is filed by the buyer or the seller.[40] It was also found that the Commission had not prejudged the issue of the applicable standard of review when the Commission suggested that market participants could file complaints if they believed that their contracts are unjust and unreasonable.[41] The ALJ also dismissed PUCN's argument that the Commission should apply here a more flexible

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37 *Id.* at 65,276.

38 *Id.* 65,276-77.

39 *Id.* at 65,277.

40 *Id.*

41 *Id.*

"public interest" standard.[42]

B. Exceptions

31. Complainants and PUCN assert as error the ALJ's determination that the "public interest" standard applies to the contracts at issue. Complainants argue that the Commission may apply the "public interest" standard only if it first finds the contract prices to be just and reasonable. They state that because the contracts at issue were market-based rate contracts, they were never filed with or approved by the Commission. As such, it is claimed, these contracts were never intended to be regarded as inviolable, since the Commission is required, in these cases, to monitor and, if necessary, ensure that the markets in which these contracts are performed, continue to function in a manner that will support or justify a continuation of market-based pricing.

32. In response, Respondents and Staff state that the ALJ correctly found that an initial review of the challenged contracts has already occurred under Section 205 when the Commission approved the WSPP Agreement, and after further proceedings, found that all Respondents are authorized to sell power at market-based rates and that they did not possess the ability to exercise market power. Staff adds that by virtue of the granted market-based rate authority, the rates, terms and conditions Respondents negotiate are deemed to be just and reasonable. Staff argues that inasmuch as the rates, terms and conditions included within the

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[42] *Id.*

Confirmation Agreements are presumed to be just and reasonable, any need for prior Commission approval has been met. To that end, Mirant further asserts that the Commission previously has held that, in the case of market-based rates, the "just and reasonable" standard of Section 205 is satisfied by the Commission's determination, prior to the effectiveness of those rates, that the utility and its affiliates lack market power or have taken steps to mitigate market power. Moreover, Respondents and Staff state that parties to whom the Commission has granted market-based rate authority file contracts for informational purposes only. Therefore, assert Respondents, application of the *Mobile-Sierra* doctrine cannot depend upon the filing and approval of a contract where no such approval process is available from, or required by, the Commission.

33. Complainants and PUCN further argue that the ALJ erred in ruling that the "public interest" standard applies in the absence of an express clause granting the parties the right to seek revisions to their contracts pursuant to Section 206 of the FPA. These parties assert that such a clause should not be required as a prerequisite to the exercise of their Section 206 rights. They argue that in the absence of this language, the parties should be deemed to be bound only by the "just and reasonable" standard and should be free to seek unilateral changes to their contracts under the "just and reasonable" standard. Complainants and PUCN also argue that there was no evidence in this case that any party to the contracts at issue intended to be bound by the "public interest" standard. They state that if the parties had intended to limit their Section 206 rights in this way, they could have done so expressly.

34. In response, Respondents argue that the record shows that the subject contracts were voluntarily negotiated by sophisticated parties and no party expressly reserved the right to seek unilateral modifications under the "just and reasonable" standard of review. Respondents and Staff state that courts and the Commission have consistently applied the "public interest" standard of review to contracts, such as those at issue here, that contain a specific, fixed rate and where a party has not expressly preserved its right to seek unilateral modification to the contract rates.

35. While PUCN argues that third parties, including Nevada ratepayers, should not be bound by the *Mobile-Sierra* doctrine because they are not parties to the challenged contracts, Allegheny states that PUCN's argument, if accepted, would effectively eliminate the "public interest" standard altogether. Moreover, Allegheny states that a utility cannot simply claim that it is acting on behalf of its customers to avoid the "public interest" standard of review.[43] To that end, Respondents contend that the potential excessive burden on customers is not a basis for determining whether the "public interest" standard applies, but rather, is part of the "public interest" test itself. Respondents further assert that to allow the mere presence of an intervenor, such as PUCN, to lower the standard of review would invite any future complainant to simply line up a supporting intervenor so that the lower standard would apply to the complaint.

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[43] *See* Potomac Elec. Power Co. v. Allegheny Power Sys., 85 F.E.R.C. ¶ 61,633 (1998).

C. Commission Determination

36. The issue of the applicable standard of review was set for hearing because we did not believe that we had a sufficient record to definitively address the *Mobile-Sierra* issue.

We now have the benefit of a complete evidentiary record, including witness testimony, on the issue of the applicable standard of review. The record shows that the challenged contracts were entered into under an umbrella WSPP Agreement and consequently incorporate terms and conditions of the WSPP Agreement, including Section 6.1.[44] Section 6.1 of the WSPP Agreement allows parties to jointly seek modification of the rates, terms and conditions of the contracts under Section 205 of the FPA; however, it does not address the parties' FPA Section 206 rights. This is the provision that the ALJ was instructed to interpret. We agree with the ALJ's interpretation of Section 6.1 of the WSPP Agreement. Section 6.1 of the WSPP Agreement allows parties to jointly seek modification of the rates, terms and conditions of a contract under FPA Section 205, but does not address customer rights to file a complaint pursuant to FPA Section 206. On first glance, Section 6.1 is confusing since Section 205 is the statutory provision by which a seller makes a rate change filing[45] and Section 206 is the

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[44] Ex. NPC-14, Section 26 and NPC-14 at 56.

[45] Section 205 applies only to rate changes by public utility sellers. Thus, a buyer under a contract does not file either individually or jointly for a rate change under Section 205. It may intervene in support of a public utility's Section 205

provision by which a non-seller (purchaser or other affected person) may seek a rate change. However, we conclude that the reference to a "joint" Section 205 filing evidences an intent that neither seller nor buyer be able to seek changes under Section 205 or 206 of the FPA other than under the "public interest" standard of review. Although the parties could have used specific language disallowing a unilateral filing by the seller under Section 205, or the filing of a complaint by the buyer under Section 206 of the FPA, the most reasonable reading of Section 6.1 is that they intended to exclude any unilateral filings at the Commission. As the ALJ explained, "under the maxim 'expressio unius est exclusio alterius,' (the expression of one thing is the exclusion of the other), the only interpretation of Section 6.1 of the [WSPP Agreement] is that the parties thought about, contemplated, and provided for applications to FERC, excluding all applications not specifically provided for in the contracts." [46]

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rate filing but does not institute rate change filings under that section.

[46] Initial Decision at 65,276. An opposite interpretation would fly in the face of the D.C. Circuit Court decision in Texaco Inc. v. FERC, 148 F.3d 1091 (D.C. Cir. 1998). Mojave, a natural gas pipeline company, and Texaco, a shipper, entered into service agreements that established a formula rate for transportation services and in which Mojave agreed that it "shall not exercise [its] rights under Section 4 of the [NGA] to change the rates to be paid by the Shipper." *Id.* at 1095. In subsequent proceedings to reform the contracts, the Commission found that the contracts were not subject to the *Mobile-Sierra* doctrine because "by expressly prohibiting only unilateral rate changes proposed under NGA Section 4, the contracts...implicitly recognize the Commission's ability to take the instant Section 5 action." *Id.*, quoting Mojave Pipeline Co., 62 F.E.R.C. ¶ 61,195 at 62,365 (1993). The Court rejected the

Therefore, the parties to the challenged contracts did not intend to retain for Complainants the right to unilaterally seek changes to their contracts. Thus, we conclude that Complainants must demonstrate that the contracts in question are contrary to the public interest in order to support modification of the contracts.

37. Complainants also argue that the "public interest" standard does not apply to the market-based rate contracts at issue here because these contracts have not been previously reviewed and accepted for filing by the Commission. The need for prior Commission review in these circumstances was met when, after determining that the Respondents lacked market power or had taken steps to mitigate it, the Commission authorized all of the Respondents in this proceeding to make sales of power at market-based rates.[47] A seller that has been granted market-

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Commission's approach and explained that "the law is quite clear: absent contractual language 'susceptible to the construction that the rate may be altered while the contract[] subsists,' the *Mobile-Sierra* doctrine applies." *Id.*, 158 F.3d at 1096, quoting Appalachian Power Co. v. FPC, 529 F.2d 342, 348 (D.C. Cir. 1976). Sections 4 and 5 of the NGA are similar to Sections 205 and 206 of the FPA and should be interpreted consistently. Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 686 (D.C. Cir. 2000). Our conclusion that contracts entered into pursuant to the terms and conditions set forth in the WSPP Agreement are subject to the *Mobile-Sierra* doctrine is consistent with *Texaco*.

[47] *See* Allegheny Energy Supply Co., 88 F.E.R.C. ¶ 61,303 (1999); American Elec. Power Serv. Corp., 81 F.E.R.C. ¶ 61,129 (1997); BP Energy Company, Director Letter Order, Docket No. ER00-3614-000 (Oct. 18, 2000); Calpine Energy Services, L.P., Director Letter Order, Docket No. ER00-3562-000 (Sept. 21, 2000.); Tenneco Energy Marketing Company, Director Letter

based rate authority may enter into power sales contracts without first seeking Commission authorization of the provisions of an individual contract (except for certain affiliate contracts). The Commission is not required specifically to review each agreement since the Commission, when it grants umbrella market-based rate authorization, pre-determines that rates under future contracts entered into pursuant to the market-based rate authorization will be just and reasonable. The "just and reasonable" standard of Section 205(e) of the FPA [48] is satisfied by the Commission's determination that the utility (and its affiliates) lacks market power or has taken sufficient steps to mitigate market power.[49] As noted in *GWF Energy, LLC*,[50] if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of market-based rate authority (i.e., the original acceptance of the market-based rate tariff) a pointless exercise of no value to anyone. For these reasons, the Commission has expressly excluded from the subjects set for hearing issues

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Order, Docket No. ER95-428-000 (March 30 ,1995); Enron Power Mktg., Inc., 65 F.E.R.C. ¶ 61,305 (1993); S. Co. Energy Mktg., LP, 72 F.E.R.C. ¶ 61,324 (1995); Morgan Stanley Capital Group, Inc., 69 F.E.R.C. ¶ 61,175 (1994); Noram Energy Services Inc., Director Letter Order, Docket No. ER94-1247-000 (July 25, 1994)

[48] 16 U.S.C. § 824d(e) (2000).

[49] *See, e.g.*, California *ex rel.* Bill Lockyer v. British Columbia Power Exch. Corp., *et al.*, 99 F.E.R.C. ¶ 61,247, at 62,063 (2002).

[50] *See* GWF Energy, L.L.C., *et al.*, 98 F.E.R.C. ¶ 61,330, at 62,390 (2002).

concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority.[51]

D. Requests for Rehearing

38. We will also address Snohomish's and Senator Cantwell's requests for rehearing of the Rehearing Order. In that order, we granted Morgan Stanley's request for rehearing of the April 11 Order and ruled that its contract with Snohomish should be examined under the "public interest" standard of review upon the finding that Section 39B of the Morgan Stanley-Snohomish Confirmation Agreement explicitly restricts the parties' rights to propose changes to the contract under Sections 205 and 206 of the FPA[52] On rehearing, Snohomish and Senator Cantwell challenge this Commission determination.

39. In particular, Snohomish argues that Section 39B of its contract with Morgan Stanley is not applicable to the instant complaint because it only addresses unilateral challenges of the contract rate, but not other terms, whereas Snohomish seeks to shorten the length of the term of the contract. We disagree. In a contract entered into pursuant to market-based rate authority, the negotiated term is intricately linked to the contract rate. The primary basis for Snohomish's complaint is the allegation that the rate in its contract with Morgan Stanley is unjust and unreasonable, not that the term of the

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[51] *See* April 11 Order at 61,191.

[52] *See* Rehearing Order at 62,047-48.

contract is unjustifiably long.[53]

40. Furthermore, even if Snohomish's contention that Section 39B applies only to challenges of the contract rate were true, the Snohomish-Morgan Stanley contract would still be subject to the "public interest" standard of review in light of our adoption of the ALJ's interpretation of Section 6.1 of the WSPP Agreement. If Section 39B were not dispositive in regard to the length of the contract, then Section 6.1 of the WSPP Agreement would apply. Section 6.1 explicitly applies to "rates, charges, classifications, service, terms, or conditions affecting the WSPP transactions" and, as we held above, it reveals the parties' intention to disallow any unilateral changes. Thus, any proposed modifications to the WSPP Agreement and contracts entered thereunder will be evaluated under the "public interest" standard of review.

41. Additionally, Senator Cantwell asserts that the Commission should not apply the "public interest" standard of review to the Snohomish-Morgan Stanley contract, but should apply the "just and reasonable" standard of review, because the *Mobile-Sierra* doctrine does not apply to parties in this proceeding, such as Senator Cantwell, who are not signatories to the Snohomish-Morgan Stanley contract. We cannot find any legal precedent to support this distinction. There is no Commission or

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[53] *See* Pub. Util. Dist. No. 1 of Snohomish County, Wash. v. American Elec. Power Serv. Corp., 100 F.E.R.C. ¶ 61,296, at 62,340 (2002) (rejecting the same contention by Snohomish in regard to the identical provision in its contract with a different seller).

court precedent that supports a finding that a non-signatory party may challenge a *Mobile-Sierra* contract under the "just and reasonable" standard of review, as opposed to the "public interest" standard of review.[54]

2. Whether Contract Modification is Warranted under the "Public Interest" Standard of Review

42. In their complaints, Complainants alleged that the prices in their forward bilateral contracts were the product of the California ISO and PX spot market dysfunctions. In the April 11 Order, we concluded that in the evidence presented thus far, the Complainants failed to show that the dysfunctional California ISO and PX spot markets had an adverse effect on the long-term, bilateral markets in California, Nevada and Washington. We further stated that in order to meet their burden of proof to reform these market-based contracts, Complainants would need to demonstrate that there was such an adverse effect and, if so, whether modification of any individual contract at issue is warranted.[55]

43. To this end, the Commission instructed the ALJ to consider and the parties to submit evidence

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[54] Carolina Power and Light Co., 69 F.E.R.C. ¶ 61,078 (1994), cited by Senator Cantwell, is inapposite. It involved a Commission directive to revise a settlement agreement that had been submitted for Commission acceptance, and not, as in this case, a complaint challenging an existing market-based rate contract for the sale of power.

[55] *See* April 11 Order at 61,191.

on the totality of purchases and sales and the conditions present at the time the contracts were entered into. In particular, the Commission proposed the following list of evidentiary factors: (1) Complainants' overall portfolio as well as their own sales (*e.g.*, pattern, duration, price); (2) whether Complainants' transactions were physical or financial in nature and designed to serve Complainants' load; (3) the terms, conditions and rate over the entire duration of each contract (*e.g.*, whether the contract is front-end loaded); (4) what other alternatives were available to buyers and sellers; (5) whether at the time it was a reasonable decision to enter into these contracts (*e.g.*, duration, scope and time period, and the participants' expectations as to the duration of dysfunctions in the California ISO and PX markets); (6) the terms and conditions of any request for proposals, and the process and procedures the complainants used to evaluate the contracts, including any changes in offered rates, terms, and conditions mandated or negotiated by the Complainants; and (7) the relation of the contract rates to the Commission's previously identified benchmark for long-term contracts. The parties were also encouraged to present evidence on: (1) the effect of the contracts on the financial health of Complainants; (2) the effect of the contracts on wholesale and retail customers; (3) the impacts contract modification may have on the nation's energy markets, including, but not limited to, impacts on investment in new generation and transmission infrastructure, and effect on confidence in competitive markets; (4) the willingness of market participants to enter into long-term contracts in the future and the prices and terms and conditions of such contracts; and (5) the potential modification of

other existing energy contracts.

A. Initial Decision

44. As an initial matter, the ALJ concluded that Complainants failed to prove that the dysfunctional ISO and PX spot markets adversely affected the Western long-term bilateral markets. In particular, it was established that Complainants did not perform any analysis regarding the impact of market fundamentals on the forward prices.[56] It was also found that Complainants' witnesses who tried to do analyses only measured one factor, and they did not account for all of the changing market fundamentals which impacted forward prices.[57] Furthermore, according to the ALJ's findings, Complainants did not provide any evidence that the ISO and PX spot market prices drove the spot prices throughout the West.[58] The ALJ also found that Complainants did not perform any survey or study to determine the market participants' expectations concerning the continuation of spot market dysfunctions.[59] Complainants did not prove what role any factors, including market fundamentals, had in the development of any forward price curves.[60]

45. In addition, the ALJ also found that Complainants did not present any evidence of

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[56] Initial Decision at 65,290.

[57] *Id.*

[58] *Id.*

[59] *Id.* at 65,289.

[60] *Id.* at 65,295.

specific manipulation by any Respondents which impacted the forward markets generally or any contract at issue in this case specifically. It was established that Respondents' witnesses refuted the allegations that the impacts of Enron's trading strategies, withholding and exercise of market power in the ISO and PX spot markets, inflated prices in the forward markets. [61] According to the ALJ's finding, the allegations of withholding in the ISO and PX markets did not contain any specific studies proving withholding by any Respondent in any market, spot or forward. [62] Moreover, it was found that no evidence was presented that any seller actually engaged in discriminatory pricing regarding the contracts at issue in this proceeding. [63]

46. Further, the ALJ examined the totality of circumstances surrounding the contracts at issue and then considered whether the Complainants have met their burden of proof under the "public interest" standard. As a result, the ALJ found that substantial evidence in this case demonstrated that the contracts should not be modified or abrogated. [64]

47. In particular, it was established that the Nevada Companies' contracts were entered into pursuant to an Accelerated Procurement Strategy (APS), which was a "radical proposal" unsupported by any analysis or quantitative studies concerning the Companies' exposure in the event of the fall in

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[61] *Id.* at 65,294.

[62] *Id.*

[63] *Id.*

[64] *Id.* at 65,298.

prices.[65] The ALJ also found that the APS was undertaken due to the Nevada Companies' perceived need to secure "reliability at any price" and desire to buy as much power as they could before their counterparties discovered their already "precarious financial position."[66]

48. It was also found that the Nevada Companies did not pursue a mix of products, which was contrary to the recommendation contained in their Comprehensive Energy Plan (CEP) submitted to the PUCN in January 2001.[67] Instead, the Nevada Companies focused only on standardized products available in the broker markets. The ALJ determined that each of the Nevada Companies' transactions was a "brokered" transaction, i.e., it was entered into by the parties using an independent, third-party broker without Nevada Companies' knowledge of the counter party's identity.[68]

49. The ALJ also established that even though the Nevada Companies had authority to enter into forward contracts of up to three years of duration without additional regulatory approval, virtually all of their contracts at issue in this proceeding were for terms of one year or less and many of the contracts were for terms of only 90 days.[69] Moreover, it was

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[65] *Id.* at 65,299.

[66] *Id.*

[67] *Id.*

[68] *Id.* at 65,273.

[69] *Id.*

determined that there had been long-term, structured transactions offered, but not accepted by the Nevada Companies.[70] The ALJ concluded that since the forward curve at the time reflected backwardation,[71] lower average prices could have been obtained by entering into longer-term contracts.[72]

50. Additionally, the ALJ found that the Nevada Companies purchased more power than necessary to cover their load requirements.[73] However, they ignored the prospect that power prices could decrease. It was also established that the Nevada Companies relied on prices reflected in broker sheets, checking price quotes and reading a few trade publications to guide their expectations about the future of energy prices.[74] As determined by the ALJ, the Nevada Companies, however, did not analyze the impact of new generation on forward prices, or the supply situation for 2002 and 2003.[75] The ALJ concluded that the purchases were not made for reliability purposes.[76]

51. The ALJ further established that the Respondents were price takers. They did not set the

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[70] *Id.* at 65,302 n.357.

[71] Backwardation denotes the excess of spot prices over the Long Run Marginal Costs. *Id.* at 65,278.

[72] *Id.* at 65,300.

[73] *Id.* at 65,301.

[74] *Id.*

[75] *Id.*

[76] *Id.*

price, but instead were subject to the prevailing market prices.[77] The ALJ also found that the Nevada Companies were not forced to enter into any of the contracts.[78] According to the ALJ's finding, the transactions often occurred in a matter of seconds and the evidence did not show any pressure, uncertainty, hesitancy, or a lack of understanding about what Nevada Companies were purchasing.[79]

52. It was further established that Nevada Power's contracts with Mirant, Reliant, and Morgan Stanley were sleeve transactions, i.e., transactions in which a third party enters into contracts with two other parties in order to facilitate a transaction between the two parties. The ALJ found that Nevada Power negotiated the transaction price with another third-party seller, and the sleeving Respondents facilitated the transactions by taking on Nevada Power's credit risk. It was also determined that in return for this sleeving service, Mirant, Reliant and Morgan Stanley received no or minimal fees per megawatt traded.[80] The ALJ thus concluded that it would be unfair to require any Respondent who sleeved on behalf of the Nevada Companies to pay refunds or receive a downward price adjustment for transactions that were a service to the Nevada Companies, particularly when the Respondents cannot seek recovery from the third-party market participant who sold the Respondents power.[81]

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77 *Id.* at 65,302.

78 *Id.*

79 *Id.*

80 *Id.* at 65,319.

81 *Id.*

53. It was also found that certain transactions challenged by the Nevada Companies were structured as locational basis swaps. The ALJ determined that the Nevada Companies entered into these swap transactions to effectively move power to a desired delivery point without having to secure transmission capacity and presented no evidence that these arrangements were unjust, unreasonable or otherwise improper in any way.[82]

54. As for Snohomish's complaint, the ALJ found that Snohomish profited from reselling power that it had purchased in the wholesale market during 2000 and early 2001.[83] The ALJ also concluded that Snohomish's decision to enter into the contract with Morgan Stanley was reasonable given the circumstances at the time.[84] Finally, it was also found that Snohomish had other alternatives available to it.[85]

55. In particular, it was found that after Snohomish's Board resolved to raise retail rates an average of thirty-five percent,[86] Snohomish started its bid solicitation process by issuing a Request for Proposal (RFP) containing three bid options. Under Snohomish's RFP, Snohomish was not required to select any of the bids submitted in response to the

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[82] *Id.*

[83] *Id.* at 65,323.

[84] *Id.* at 65,303.

[85] *Id.*

[86] *Id.*

RFP and could reject any and all bids and terminate negotiations at any time.[87]

56. The Initial Decision gives an elaborate account of negotiations that took place between Snohomish and Morgan Stanley. In particular, the ALJ found that Morgan Stanley had to resubmit a bid twice with modified terms suggested by Snohomish. [88] It was further established that throughout the negotiations, Snohomish's goal was to keep the price of the contract to under the $125 "placeholder" established by the Snohomish Board in December 2000, long before the RFP was announced.[89] Shorter terms at market rates were available to Snohomish, but rejected. Morgan Stanley's proposal to enter into an alternative arrangement of two separate deals, one for five years (at above market prices) and another for five to seven years (at below market prices) was also rejected by Snohomish. According to the ALJ, Snohomish had a choice of passing the risk of price volatility to the seller and pay a below market rate of $105 for the first five years, even if the contract had to be for a longer term. Moreover, it was determined that Snohomish had the choice of a shorter contract at higher prices, but rejected that choice. [90] In addition, the ALJ inferred from the corroborated testimony by one of Snohomish's witnesses that Snohomish's primary goal was to get a below market rate at any term. The ALJ thus concluded that

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[87] *Id.*

[88] *Id.* at 65,304.

[89] *Id.* at 65,303.

[90] *Id.* at 65,304.

Snohomish voluntarily chose the term of its contract.[91]

57. Furthermore, it was found that the negotiations (which included amendments to the WSPP Agreement, the form of confirmation and a collateral annex to manage the parties' credit risks) took place by telephone calls and electronic mail and Snohomish was represented by counsel at all times. It was established that Snohomish dictated the deadlines to complete negotiations and several of the contract terms.[92] The ALJ also found that shortly after Snohomish entered into the contract, it touted to its customers that the Morgan Stanley and other long-term contracts "give us a lot of security against the uncertainty of market fluctuations," and that the contracts insulate the ratepayers from market volatility.[93] According to the ALJ's findings, it was Snohomish's expectation that, based on its forward curve, its contract with Morgan Stanley would provide Snohomish with power at a price far below market for at least two years.[94]

58. Finally, the ALJ also found that Snohomish had several other available alternatives, such as: (1) continuing to purchase power in the spot market; (2) executing a forward contract for a term shorter than the term of the Morgan Stanley contract; (3) contracting for a share of a new generation plant or building its own generation; (4) purchasing a put

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[91] *Id.*

[92] *Id.*

[93] *Id.*

[94] *Id.*

option contract; and/or (5) entering into two separate agreements with a total term of nine years with one or two counterparties.[95]

59. In regard to SCWC's complaint, the ALJ found that SCWC was aware that spot market prices had risen substantially above historical levels. [96] Notwithstanding the high prices that SCWC was observing and the increased market volatility, SCWC made a decision to wait until early March 2001 to issue an RFP to replace the one-year contract it knew would expire on May 1, 2001.[97] The ALJ afforded no weight to SCWC's testimony that it had to issue an RFP at the "peak" of the energy crisis through no fault of its own and found that there is a lack of evidence of any reasons that prevented SCWC from seriously pursuing other options well before March 2001.[98] Thus, the ALJ concluded that SCWC simply chose to wait until that time before it was willing to issue an RFP and negotiate a new contract.[99]

60. It was further found that the SCWC-issued RFP was sent to the restricted list of six recipients, including Mirant. The RFP restricted bidders to terms ranging from one to seven years, indicated a preference for fixed price offers and a price in the range of $90. [100] The ALJ also determined that

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[95] *Id.*

[96] *Id.* at 65,305.

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] *Id.*

SCWC received three different responses with varying options, which permitted SCWC to choose the most favorable offer.[101] According to the ALJ, SCWC made no subsequent effort to seek out other offers, consult a broker, or reissue an RFP to get other proposals.[102]

61. The ALJ also found that the negotiations between Mirant and SCWC focused only on the price and there is no evidence that anyone from SCWC attempted to negotiate non-price terms during the parties' discussions from March 14 to March 16, 2001, including any specific modifications to the WSPP Agreement to permit SCWC to seek unilateral modifications to the contract.[103]

62. The ALJ also established that the $95/MWh price was substantially below the then prevailing expected future spot market prices for the remainder of 2001 through the summer of 2002.[104] According to the ALJ's findings, SCWC expected prices to drop in the fall of 2001; notwithstanding this fact, it chose to enter into this contract. The ALJ concluded that as a result, Mirant took on the market risk when it agreed to sell to SCWC at $95/MWh. The ALJ thus concluded that the savings to SCWC were front-end loaded and provided stability and price protection from volatility for SCWC; conversely, Mirant agreed to take an up-front loss in the early years of the contract, with the expectation that the losses would

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[101] *Id.*

[102] *Id.*

[103] *Id.* at 65,306.

[104] *Id.*

be made up in later years.[105]

63. In addition, the ALJ found SCWC's witness testimony concerning SCWC's expectations regarding the duration of the California crisis to be contradictory and thus not credible.[106] It was also found that SCWC had available to it and actively explored a variety of resource options.[107] For instance, in October 2000 (after a summer of high prices) Dynegy Inc. offered to extend its contract with SCWC, based on a "blend and extend" rate of between $46.50/MWh to $54.50/MWh, depending on the term of the extension. Moreover, the ALJ found that SCWC and Enron discussed in November 2000 a contract for differences by which SCWC could hedge costs at $55.73/MWh.[108] Also, SCWC could have chosen to rely on the spot market. Additionally, SCWC could have entered into a shorter term block forward contract for the Summer of 2001. It was also established that SCWC had a variety of responses to its RFP, from which it could have chosen a proposal other than Mirant's, including contracts for less than five years.[109]

64. The ALJ further found that contract modification will harm credit and investor confidence by altering the perception of a formerly stable cash flow into an undependable, risky cash

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[105] *Id.*

[106] *Id.*

[107] *Id.* at 65,307.

[108] *Id.*

[109] *Id.*

flow.[110] The ALJ also determined that modification of the contracts would cause market participants to suffer adverse credit and financial consequences, which could lead to hesitancy to enter into forward contracts, because of the uncertainty of the enforceability of such contracts.[111] This, it was found, could erode investor confidence and willingness to invest in merchant energy projects, which, in turn, could have an adverse effect on infrastructure development, especially at a time when Western markets need new generation and transmission. Additionally, the ALJ established that contract modification in this case could result in increased prices to compensate for increased risks.[112]

65. Additionally, the ALJ concluded that modification of these long-term contracts may preclude sellers from ever making a profit on the transaction.[113] The ALJ explained that the sellers in this case had to purchase power in the open market at prevailing market rates because they did not own generation to serve the market in question. Respondents thus covered their forward contracts by purchasing hedges, or forward contracts of their own when the overall balance of their portfolios demanded it. [114] The ALJ further found that Respondents were paying prices in the same price range as those reflected in the contracts in dispute

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[110] *Id.* at 65,308.

[111] *Id.*

[112] *Id.*

[113] *Id.* at 65,306 and 65,309.

[114] *Id.* at 65,309.

due to the fact that they were buying the hedges in the same market as they were selling to the Complainants in this case. Additionally, the ALJ determined that to the extent a seller was hedging a long-term contract, such as Snohomish's or SCWC's, which have prices below market up-front, the seller likely hedged the contract with high-cost power up-front for which it will not be reimbursed until later years. Consequently, the ALJ concluded that the contract reformation would deprive Respondents of the benefits of their bargains, since they have already incurred costs associated with these contracts, either through hedging the contracts or delivery of the power.[115]

66. Furthermore, the ALJ found that the Complainants did not offer any evidence to overcome their high burden under the "public interest" standard.[116] Specifically, it was established that evidence in the record does not show any discriminatory treatment of the Nevada Companies by Respondents. All contracts were standard products arranged through independent third-party brokers at or below prevailing market prices.[117]

67. The ALJ also found that the contracts in question do not impose an "excessive burden" on Complainants' customers.[118] It was determined that the Nevada Companies' projections assumed that they would file for a rate decrease in excess of 20

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[115] *Id.*

[116] *Id.* at 65,310.

[117] *Id.* at 65,320.

[118] *Id.*

percent in November 2002 in their base tariff energy rate cases. In addition, the ALJ found that the Nevada Companies' cash-flow projections assume that full payment will be made to all Respondents, except Enron; however, even if they are required to pay Enron, any rate increase would be no more than five percent. Moreover, according to the ALJ, the Nevada Companies' cash flow projections show positive cash balances for each of the next several years, even assuming dividend payments and scheduled debt repayments, which indicates that the Nevada Companies are financially healthy companies with a sufficient equity ratio to make such payments.[119]

68. Further, the ALJ found no evidence that Complainants' ability to serve their customers is threatened. Specifically, according to the ALJ, the Nevada Companies' allegations of financial distress are not supported by record evidence. The ALJ also held that the drop in the Nevada Companies' credit rating to below investment grade occurred only after issuance of the PUCN's order and thus was not the result of the contracts at issue.[120]

69. The ALJ also found that SCWC did not adduce any evidence of financial hardships either for itself or its ratepayers.[121] In accordance with the terms of the retail rate settlement reached with the CPUC, there is no rate increase at all for ratepayers who are permanent residents of SCWC's service

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[119] *Id.*

[120] *Id.* at 65,321.

[121] *Id.*

territory and other ratepayers will face an average monthly electric bill of $35.13.[122]

70. The ALJ further found that the record does not establish that SCWC's ability to continue doing business is in any way threatened if the contract is not reformed or that the contract has a negative impact on its financial health or the financial health of its shareholders. [123] According to the ALJ's findings, the contract commenced in April, but SCWC did not need it until May when it bought the power from Mirant at $95/MWh, and sold it back to Mirant at $173/MWh, thus realizing a healthy profit.[124]

71. The ALJ also found the price of the SCWC contract to be reasonable, especially in light of the fact that Mirant, as a power marketer, had to purchase power in the market in order to resell it to SCWC. Moreover, according to the ALJ, the SCWC contract provides significant benefits, including the fact that Mirant took on the risk of supplying SCWC with a 15-MW "odd lot" sale, whereas energy is typically traded in 25-MW blocks.[125]

72. The ALJ also noted the fact that Mirant will be directly harmed if the SCWC contract is modified. According to the record, Mirant lost a substantial amount of money on the SCWC contract from April 1 to December 31, 2001 and would be able to earn any

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[122] *Id.*

[123] *Id.*

[124] *Id.*

[125] *Id.*

profit margin on the SCWC contract only if the contract price is honored through the term.[126]

73. As for Snohomish's contract, the ALJ concluded that Snohomish failed to meet its burden of proof because the record did not have any evidence regarding the impact of the contract upon ratepayers. The ALJ gave no weight to the testimony from six Snohomish ratepayers describing how rate increases impacted them because the rate increase preceded the contract at issue.[127] The ALJ also found irrelevant Snohomish's claim of unequal bargaining power. [128] Additionally, Snohomish's allegation regarding the discriminatory nature of the challenged contract was also found to be without merit. The ALJ explained that the *Mobile-Sierra* doctrine had been applied to allegations of discriminatory or preferential treatment to the detriment of other purchasers who were not parties to the contract, whereas Snohomish's claim was based on the fact that other parties who contracted with Morgan Stanley had other contract terms.[129]

74. Additionally, it was established that Snohomish derived a net profit of over $17 million in the first five months of 2001 by selling power at an average price of $134 MWh at the same time when it was purchasing power from Morgan Stanley at $105/MWh. [130] The ALJ also found that the

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[126] *Id.* at 65,322.

[127] *Id.* at 65,311 and 65,322.

[128] *Id.* at 65,322.

[129] *Id.* at 65,322-33.

[130] *Id.*

Snohomish-Morgan Stanley contract was no more than five percent of Snohomish's current portfolio costs and had a small impact on rates.[131] It was determined that the contract at issue was only three percent of Snohomish's load and resulted in an eight percent increase over existing rates in 2001, while other contracts accounted for an increase of fifty-one percent over existing rates.[132]

75. Based on the above, the ALJ concluded that the Complainants failed to meet their burden of proof under the "public interest" standard and that even under the "just and reasonable" standard their complaints would not suffice.[133]

76. In addition, the ALJ addressed Morgan Stanley, Reliant, El Paso and Enron's contention that their contracts with the Nevada Companies had been terminated on the ground that the Nevada Companies failed to satisfy the credit requirements of the WSPP Agreement. The ALJ ruled that the Commission retained jurisdiction over the contracts which had been set for hearing and subsequently terminated and that the contract termination issue would be more pertinent to remedies if the Commission found that the contracts should be modified.[134]

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[131] *Id.*

[132] *Id.*

[133] *Id.* at 65,325.

[134] *Id.*

B. Exceptions

77. Complainants assert that the ALJ erroneously found that the dysfunctional California ISO and PX spot markets did not adversely affect the Western long-term bilateral market. In Nevada Companies' opinion, the ALJ erred in considering whether and why the California ISO and PX spot markets were dysfunctional, because these issues have already been determined by the Commission and were not set for hearing. Nevada Power also asserts that the ALJ's erroneous determination that the short-term energy markets were not dysfunctional during most of the relevant period influenced, in turn, the ALJ's erroneous determination that the spot markets could not have adversely affected prices in the forward markets.

78. SCWC adds that spot and forward market prices were moving together and were increasing when it executed the Mirant contract (in March 2001), and that these price increases were attributable to market dysfunction or market power, not changes in market fundamentals, as the ALJ concluded. The PUCN asserts that the relevant markets were subject to market manipulation and other forms of anti-competitive behavior, and that these conditions led to the market dysfunctions, which resulted in excessive forward contract prices.

79. Complainants further allege that the ALJ erred in concluding that contract modification is not warranted and that the Complainants failed to meet the "public interest" standard of review. The PUCN argues that modifying the excessive contract prices at issue would not be contrary to the public interest,

given the harm that these costs pose to the Nevada Companies, their ratepayers, and the market as a whole. SCWC asserts that the Mirant contract constitutes the major part of SCWC's wholesale energy purchases, and that the costs under this contract over and above the $74/MWh benchmark established by the Commission warrants contract revision, even under the "public interest" standard.

80. Respondents and Staff assert that the ALJ correctly determined that Complainants failed to demonstrate that dysfunctional ISO and PX spot markets adversely affected the long-term bilateral markets. They further argue that the ALJ properly determined that market fundamentals were a significant contributor to high prices in the spot markets during the relevant period. Mirant adds that, contrary to SCWC's assertion, the ALJ's findings are fully consistent with prior Commission findings that the ISO and PX spot markets were impacted both by dysfunctions, and also by dramatic changes in market fundamentals and competitive market conditions. Morgan Stanley argues that although prior Commission orders found that the spot and forward markets are linked, the Commission did not determine whether dysfunctions that existed solely in the centralized California spot markets had any effect on the forward markets in California and the rest of the West.

81. Respondents and Staff argue that the ALJ properly determined that any adverse effect of the alleged dysfunctions in the ISO and PX spot markets on the Western bilateral forward market was not of a magnitude warranting modification of the challenged contract prices. In line with the Initial

Decision, Respondents argue that the testimony offered by Complainants on this point was not entitled to substantial weight. Respondents assert that Complainants' witnesses assumed the conclusions they set out to prove, failed to consider relevant input costs and other factors in their analyses (such as long-run marginal costs, emissions costs, and scarcity rents), or simply presented irrelevant testimony.

82. In addition, Respondents and Staff asserts that, contrary to the Nevada Companies' assertion, it was reasonable for the ALJ to consider Complainants' purchasing practices in considering whether modification of the contracts is warranted. Staff states that in light of the directives in the April 11 Order, the rationale underlying the Nevada Companies' purchasing practices, and the extent to which they left the Nevada Companies open to unnecessary risks, was a legitimate and relevant subject for inquiry.

83. Respondents also argue that the ALJ correctly concluded that Complainants failed to meet their burden of proof under the "public interest" standard. With regard to the Nevada Companies' contract, Allegheny and Staff assert that the Nevada Companies failed each prong of the *Mobile-Sierra* test. Specifically, Allegheny states that the Nevada Companies never alleged, or presented any evidence showing, that the challenged contract prices were unduly discriminatory, resulted in an imposition of an "excessive burden" on other customers, or threatened their ability to service their customers. Allegheny asserts that the Nevada Companies made only generalized assertions, without factual support.

84. With regard to SCWC, Staff agrees with the ALJ that there is a lack of substantial evidence showing that the financial health of SCWC has been negatively impacted by the subject contract, particularly in light of a recent settlement approved by the CPUC. Staff asserts that while SCWC contests most of the ALJ's findings, it denies virtually none of the facts adduced by the ALJ and offers no probative evidence that the contract with Mirant produces an excessive burden.

85. As for Snohomish's complaint, Morgan Stanley and Staff argue that Snohomish failed to demonstrate that the term of its contract with Morgan Stanley might impair its financial ability to continue service. On the contrary, Morgan Stanley contends that the ALJ correctly determined that Snohomish's 2001 Financial Statement shows that its financial condition is strong. In any case, Morgan Stanley argues that the ALJ rightly determined that there are complicating factors in any Commission effort to apply the excessive burden test to mostly retail customers of complainants like Snohomish, since the Commission has no jurisdiction over the rates charged by a buyer, such as Snohomish, to its retail customers.

86. In addition, Enron challenges the ALJ's finding that further examination of the Enron contracts with the Nevada Companies in this case may be necessary pending the outcome of two other

cases involving Enron now before the Commission.[135] Enron argues that issues related to the Enron contracts were litigated to finality in this proceeding.

87. In response to Enron, SCWC, Nevada Companies, and Staff note that the April 11 Order specifically stated that issues relating to Respondents' exercise of market power or market manipulation were excluded from the proceeding, because that nature of inquiry was considered duplicative of matters pending before the Commission in *Fact-Finding Investigation into Possible Manipulation of Electric and Natural Gas Prices*, Docket No. PA02-2-000. SCWC and Nevada Companies further assert that pursuant to the Commission's admonishment, the ALJ prohibited parties from introducing evidence to demonstrate that any of the terms and conditions in the contracts at issue resulted from the exercise of market power or market manipulation. Accordingly, SCWC and Nevada Companies dispute Enron's assertion that, if the Commission upholds the Initial Decision, Complainants are barred by the operation of *res judicata* and collateral estoppel from seeking any further review of those contracts based on the possible market manipulation by Respondents.

88. SCWC further asserts that if the Commission upholds the ALJ's conclusion that the public interest standard applies to the contracts at issue, the Commission should not reach a final decision on the merits of SCWC's complaint until the investigation

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[135] The two referenced cases are Pub. Util. Comm'n of Cal. v. El Paso Natural Gas Co., Docket No. RP00-241-000 and El Paso Electric Co., Docket No. EL02-113-000.

in Docket No. PA02-2-000 is complete and SCWC is afforded an opportunity to demonstrate that market abuses and manipulation adversely affected the Mirant contract.

89. Staff, however, argues that Complainants were not required to demonstrate market power or manipulation to prevail and that therefore, it is unnecessary to reopen the record in this proceeding unless the investigation in Docket No. PA02-2-000 suggests it is so warranted.

90. Nevada Companies and Staff also urge rejection of Enron's alternative request that the Commission find that its unilateral termination of its contracts with Nevada Companies extinguished the Commission's jurisdiction over the contracts from the moment of termination. Nevada Companies state that the contract termination issue has never been set for hearing by the Commission and the ALJ never reached a conclusion on Enron's claim that it had terminated its contracts with Nevada Companies. Even if Enron had terminated the contracts, Nevada Companies and Staff argue that unilateral termination would not extinguish the Commission's jurisdiction over the issue of whether the contract prices are just and reasonable under Section 206. Staff adds that Enron's suggestion that Commission jurisdiction is predicated on physical delivery is misguided. Staff states that the history of Commission actions, which has been affirmed by the courts, shows that cancellation of a plant before completion, or the cancellation of deliveries, does not end the Commission's jurisdiction over a facility or contract.

C. Oral Argument

91. At the April 23 oral argument, the Complainants argued that in light of the market manipulation findings made in the Staff Report released on March 26, 2003, additional grounds exist to abrogate the contracts in question. In particular, Complainants argued that the *Mobile-Sierra* "public interest" standard has been met because the Staff investigation revealed that sellers engaged in the exercise of market power and /or market manipulation which significantly affected the forward market at the time the contracts were negotiated. Nevada Companies further stated that the contracts should not be upheld because they were obtained by fraud, misrepresentation and bad faith. Nevada Companies explained that Respondents were unlawfully manipulating market prices, thereby engaging in fraud and deception in violation of their market-based rate tariffs.

92. Furthermore, Nevada Companies requested that at the very least the Commission remand this case to the ALJ to allow Complainants to introduce evidence on market manipulation, which they were precluded from submitting by the order setting the complaints for hearing. Nevada Companies added that until on-going and future investigations of the Respondents' conduct during the relevant period of time are completed, the Commission cannot determine whether contract reformation is in the public interest.

93. Respondents argued that the Staff Report does not purport to show the effect of the California spot market dysfunctions on forward prices in the

West, but rather represents a correlation analysis. In Respondents' opinion, the Staff Report does not reveal new facts warranting a remand to the ALJ. Respondents stated that the market manipulation findings in the Staff Report are irrelevant in this case, since the market manipulation factor could only be relevant in determining the cause of the spot market dysfunctions. The dysfunctional nature of the California spot market was presumed from the very beginning and all that Complainants were required to show is the causal connection between those dysfunctions and forward market prices, which, in Respondents' opinion, Complainants failed to do.

D. Commission Determination

94. In deciding whether the Complainants have met their burden of proof under the "public interest" standard of review to justify contract modification in these cases, we rely on the evidentiary record developed in this proceeding and also take into consideration the findings of the Staff Report and evidence submitted in the 100-Day Discovery Proceeding. The Staff Report found that spot market distortions flowed through to forward power prices, particularly those for contracts of a short-term nature, i.e., one to two years time to delivery. In addition, the Staff Report and the 100-Day Discovery Proceeding suggest that the California ISO and PX markets were subjected to market manipulation and gaming. The Staff Report conclusions and the 100-Day Discovery Proceeding documents are being contested in "show cause" proceedings involving allegations and/or findings of manipulation in the spot markets. However, even if we were to assume

that these allegations and/or findings were true, they would not be determinative of the issues in the instant proceeding. The Commission has already concluded that the California ISO and PX spot markets were dysfunctional during the relevant period and that rates in those markets were unjust and unreasonable. [136] Evidence of market manipulation merely suggests yet another cause of the spot market dysfunctions and the unjust and unreasonable rates in the spot markets. However, a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a "just and reasonable" standard of review. [137] As we have previously concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the "public interest" standard of review. Under the "public interest" standard, to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms,

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[136] *See, e.g.*, San Diego Gas & Elec. Co. v. Sellers and Ancillary Serv., 93 F.E.R.C. ¶ 61,121, at 61,359-60 and 61,372 (2000); *order on reh'g and clarification*, 97 F.E.R.C. ¶ 61,275, at 62,225 (2001).

[137] This conclusion is consistent with the Staff Report recommendation that, only for contracts subject to the "just and reasonable" standard of review, the Commission should send the Staff Report findings on the influence of the spot prices on forward prices to the ALJs to use as they see fit to resolve complaints. *See* Staff Report at V-19.

and conditions are contrary to the public interest.[138] As fully discussed below, we conclude that the Complainants failed to make such a showing.

95. As determined by the ALJ and affirmed in this order, Complainants in this proceeding must meet the "public interest" standard in order to justify the requested contract modification. Based on the record, we conclude that the Complainants have failed to demonstrate that any of the three prongs announced in the *Sierra* case has been met or that any other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest and should be modified.

***Sierra* Three-Prong Test**

96. We find that there is no credible record evidence that the contracts at issue are placing the Complainants in financial distress so as to threaten their ability to continue service or that other customers will bear an excessive burden as a result of upholding the challenged contracts. In addition, there is no evidence that the contracts terms are unduly discriminatory.

97. The record demonstrates that the Nevada Companies' cash flow projections show positive cash balances for each of the next several years, even assuming dividend payments and scheduled debt repayments.[139] The Nevada Companies' cash flow

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[138] *See, e.g.*, FPC v. Sierra Pacific Power Co., 350 U.S. 348, 354-5 (1956).

[139] Ex. CES-18, CES-19, and CES-20.

projections indicate that they continue to have adequate access to capital markets.[140] All that the Nevada Companies offered in support of their position are unsupported assertions of financial hardship. The record shows that the Nevada Companies' financial condition was not caused by the contracts at issue here. By admission of Nevada Companies' own witness, the Nevada Companies were in a precarious financial position by November 2000, well before the majority of the challenged contracts were executed.[141] Any additional financial distress by the Nevada Companies resulted from the PUCN's decision disallowing recovery of costs associated with contracts that are not at issue in this proceeding.[142] The drop in the Nevada Companies' credit rating also occurred in response to this PUCN decision.[143]

98. Nevada Companies failed to show that the contract terms at issue impose an excessive burden on their customers. The record shows that in November 2002, Nevada Companies projected rate decreases of approximately 20 percent for retail service commencing June 1 and August 1, 2003.[144] According to Nevada Companies' own witness, in the event that Nevada Companies are required to pay all the Respondents, including Enron, the resulting rate

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[140] Tr. at 2494:1-5 (Shiffel); Ex. CES-20 at ¶¶ 32-33, 36, and 42.

[141] Ex. NPC-8 at 3:18.

[142] Ex. CES-2 at 26-27; Tr. at 2336 and 2676.

[143] Ex. CES-2 at 23:7-8.

[144] Ex. CES-20 at ¶ ¶ 5, 9-10; *see also*, Ex. CES-17 at 1-2.

increase would be no more than 5 percent.[145]

99. As for SCWC, there is no evidence that the challenged contract placed SCWC in financial distress threatening its ability to continue service.[146] In fact, SCWC realized a profit when it sold power purchased under the SCWC-Mirant agreement back to Mirant at a higher price.[147] Also, by entering into the contract with Mirant, SCWC avoided the risk of price volatility and achieved rate certainty.[148] The savings to SCWC resulting from its forward contracting and marketing strategy amounted to $13.26 million.[149] Similarly to Nevada Companies, SCWC offered no evidence showing that the challenged contracts impose an excessive burden on its customers. The record evidence establishes that there was no rate increase for SCWC's ratepayers who are permanent residents of SCWC's service territory pursuant to the terms of the settlement between SCWC and CPUC.[150] Under the terms of the settlement, the other group of SCWC's ratepayers, owners of second homes in SCWC's service area, were to face an average monthly electric bill of $ 35.13.[151]

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[145] Tr. at 2545:15-16.

[146] Tr. at 2933:22-2934:1.

[147] SCWC bought the power from Mirant at $95/MWh and sold it back to Mirant at $173/MWh. Tr. 2907-08.

[148] Tr. at 2943-44.

[149] Ex. SCW-1 at 11:1-14.

[150] Tr. at 2934:8:16.

[151] Tr. at 2933:22-2934:1.

100. The record also demonstrates that Snohomish presented no evidence that its contract with Morgan Stanley adversely affected Snohomish or its ratepayers. The Snohomish-Morgan Stanley contract is no more than five percent of Snohomish's portfolio costs [152] and constitutes only three percent of Snohomish's load, resulting in an eight percent increase over 2001 rates, while other contracts account for rate increase of fifty-one percent. [153] Moreover, Snohomish's rate increase occurred prior to Snohomish's negotiating its contract with Morgan Stanley, and prior to issuing the RFP for the power purchase in question.[154]

101. Furthermore, Complainants have failed to present evidence showing that the challenged contracts are unduly discriminatory. Only Snohomish alleged that its contract with Morgan Stanley is discriminatory because other parties who contracted with Morgan Stanley have other terms. This is not the type of discrimination contemplated by the *Mobile-Sierra* doctrine. Other terms in other contracts are not relevant to the determination that the contract at issue in this case is discriminatory. In the past, the *Mobile-Sierra* doctrine has been applied to allegations of discriminatory or preferential treatment to the detriment of other

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[152] Tr. at 1661.

[153] Staff IB at 55; Tr. 1661-62 and 1770.

[154] On December 13, 2000, Snohomish's Board resolved to raise retail rates an average of thirty-five percent, which allowed Snohomish to purchase up to 100 MW of power at a melded cost of up to $125/MWh. Ex. MSC-116 at 910; SNO-1 at 4:195:2; Tr. at 1723 and 1724.

purchasers who are not parties to the contract.[155] No such showing has been made by Complainants.

Evidence on Totality of Circumstances

102. In addition to the evidence on the effects of the challenged contracts on the parties and Complainants' customers, the ALJ has developed an extensive evidentiary record on the totality of circumstances preceding and following the execution of the contracts at issue. Specifically, the record shows that the Nevada Companies' contracts were standard products arranged through independent third-party brokers [156] and, consequently, the Respondents were price takers.[157] It also appears from the record that the Nevada Companies were trying to buy as much power as they could before sellers discovered their already precarious financial position.[158] To this end, the Nevada Companies abandoned their usual practice of issuing monthly RFPs to procure power[159] and employed a rather aggressive procurement strategy.[160] As a result, the

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[155] *See* Papago Tribal Auth. v. FERC, 723 F.2d 950, 953 n. 4 (D.C. Cir. 1983).

[156] Tr. at 2252:12-17; Ex. CES-1 at 3:15-27; AEP-1 at 3:21-4:16; EPME-22 at 18:6-14; MSC-21 at 8:19-9:8; RES-1 at 4:14-17.

[157] Ex. S-1 at 28:14-16; CES-1 at 4:2-15; EPME-22 at 19:7-8.

[158] Ex. CES-2 at 22:16-24:3; Tr. at 2273:10-2274:16.

[159] Ex. CES-2 at 18; CES-8; Ex. CES-39; S-6 at 16-17; Tr. 2328, 2581-83, and 2614-15.

[160] Ex. CES-2 at 18:12-13; Tr. at 2655:22-2656:2; Ex. CES-2 at 15:8; Tr. at 2629:24-2630:1.

Nevada Companies purchased more power than was necessary to serve their native load.[161] In fact, the Nevada Companies doubled their wholesale power purchases from the previous year, buying in excess of their own sales to retail customers, and selling more than four times as much wholesale power as they did in 2000.[162]

103. Additionally, the Nevada Companies failed to hedge for the possible risk that spot market prices might fall,[163] and did not pursue a mix of products to reduce risks associated with market volatility through portfolio diversification. Contrary to the recommendations in their Comprehensive Energy Plan filed with PUCN in January 2001,[164] Nevada Companies bought standardized, fixed-price products. [165] In fact, Nevada Companies rejected longer-term transactions that were offered. The evidence establishes that the Nevada Companies considered two Calpine proposals at prices substantially lower than the challenged contract rate.[166] Nevada Power also concurrently considered a ten-year proposal from Duke at a similarly lower price.[167] The Nevada Companies, however, did not pursue these options.

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[161] Ex. S-6 at 28:15-29:2.

[162] Ex. EPME-18.

[163] Tr. at 2583-86; 2596-97.

[164] Ex. CES-2 at 20:18-21:7 and CES-9 at 17.

[165] Tr. at 2336:23-2337:1.

[166] Ex. CES-35.

[167] Ex. CES-34; CES-35; Tr. at 2573:10; 2576:13-15.

104. Furthermore, the record demonstrates that the Nevada Companies made wholesale purchases of firm power from thirty-nine separate providers in 2000 and 2001, and Sierra Pacific reported purchases from forty-five to forty-seven separate providers in the same time frame. [168] Thus, considering the number of sellers available, it can be reasonably concluded that Complainants had choices, i.e., they were free to reject offers and turn to other suppliers.

105. As for the Snohomish-Morgan Stanley contract, the record establishes that the execution of this contract was preceded by extensive bid solicitation process and negotiations of the terms of the contract. Snohomish issued an RFP to 17 suppliers and in response received five bids, including Morgan Stanley's. [169] In fact, Snohomish required Morgan Stanley to submit its bid twice with modified terms suggested by Snohomish. [170] The record is also quite clear that Snohomish voluntarily chose the length of its contract that it now challenges. Shorter terms at lower rates were available to Snohomish but were rejected. [171] In addition, the price Snohomish negotiated for its contract with Morgan Stanley is substantially lower than the "placeholder" price of $125/MWh authorized by Snohomish's Board. [172]

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[168] Ex. RES-12 at 2.

[169] Ex. SNO-4 at 5:6-8; Ex. SNO-5. Tr. at 1796:1-15.

[170] Tr. at 1743:20-1744:5; 1752-53; 3984-85; Ex. MSC-8 at 10.

[171] Tr. at 1586-87, 1592; 1758, 1776.

[172] Staff IB at 55; Tr. at 1793.

106. Moreover, Snohomish made a profit from reselling the power it purchased from Morgan Stanley under the challenged contract. During the first five months of 2001, Snohomish sold power for a net profit of $17 million, at an average price of $134/MWh,[173] while at the same time buying power from Morgan Stanley for $105/MWh.

107. In regard to the SCWC-Mirant contract, the record demonstrates that it was SCWC's choice to wait until March 2001 when the energy prices were at their peak to start a bid solicitation process to replace its contract with Dynegy Inc. that was to expire in May 2001.[174] SCWC's issued RFP indicated a preference for fixed price offers for terms ranging from one to seven years at a price within the range of $90/MWh.[175] Despite the restrictive nature of the bid solicitation process employed by SCWC,[176] it received three different responses to its proposal with varying options.[177] By SCWC's own admission, at the time of contract execution, it expected the prices to drop[178]; however, such expectations did not prevent it from entering into the challenged contract. Moreover, the rate agreed upon in the SCWC-Mirant contract was lower than the expected

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[173] Tr. at 2405:1-2410:5 and 2408-09.

[174] Ex. SCW-1 at 12:5-10.

[175] Tr. at 2900-02 and 2903; Ex. MAEM-2 at 13; MAEM-9; Tr. 2904-5. Tr. at 2901:1-4; 2903:3-7; Ex. SCW-4 at 12.

[176] Tr. at 2893:19-2894:20 and 2897:8-18; Ex. SCW-1 at 17:18.

[177] Tr. at 2894:21-24; 2944:10-17.

[178] Tr. at 2927:11-2928:1.

future spot market price.[179] SCWC recognized in its CPUC testimony that a 15 MW block of energy should carry "a slight pricing premium"[180] because energy is typically traded in 25 MW blocks. Moreover, SCWC realized a profit by buying the power from Mirant at $95/MWh, and selling it back to Mirant at $173/MWh,[181] whereas Mirant lost a substantial amount of money on the SCWC contract from April 1 to December 31, 2001.[182]

Conclusion

108. Based on the above, we conclude that the contracts at issue were the result of choices voluntarily made by the Complainants and to the extent the Complainants left themselves open to unnecessary risks, it was also their choice. The record also establishes that the Complainants had better alternatives and were not compelled to enter into the contracts at issue here. For example, the Nevada Companies could have pursued a more balanced purchasing strategy, that is, instead of buying standard products with three to twelve months to delivery, Nevada Companies could have pursued a diversified portfolio of contracts of different length arranged through the RFP process, as well as independent brokers. Snohomish had an option of executing a contract for a shorter term than its contract with Morgan Stanley or entering into two separate agreements with a total term of the

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[179] Ex. MAEM-2 at 13:24-28 & 20:8-9; SCWC-4 at 4.

[180] Ex. MAEM-30 at JAD-10-11.

[181] Tr. at 2907-08.

[182] Ex. MAEM-16 at 32:14-16.

challenged contract. SCWC also had available to it and explored a variety of resource options. For example, the record demonstrates that it turned down the proposal by Dynegy Inc. to renew their existing contract at a rate substantially lower than the contract rate in question.[183]

109. Finally, there is nothing in the record before the ALJ, in the Staff Final Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contracts at issue here.

110. Therefore, based on the record, it appears that the Complainants' only basis for contract modification is their dissatisfaction with the bargain. Commission and court precedent clearly establish that allegations that contracts have become uneconomic by the passage of time do not render them contrary to the public interest under the FPA. [184] The record clearly indicates that the challenged transactions were the result of Complainants' voluntary choices. Therefore, because there is no evidence of unfairness, bad faith, or duress in the original negotiations, the Complainants are not entitled to change their bargains.[185]

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[183] Ex. MAEM-16 at 21:6-22:2.

[184] *See* Potomac Elec. Power Co. v. FERC, 210 F.3d 403, 409 (D.C. Cir. 2000) (citing Soyland Power Coop. Inc. v. Cent. Ill. Pub. Serv. Co., 51 F.E.R.C. ¶ 61,004, at 61,013 (1990). *See* also Papago, 723 F.2d at 953. Sierra, 350 U.S. at 354-355.

[185] *See* Potomac Elec. Power Co. v. FERC, 210 F.3d 403, 410 (D.C. Cir. 2000).

111. For these reasons, we affirm the ALJ's ruling and find that the Complainants have failed to meet their burden of proof under the "public interest" standard and contract modification in this case is thus not warranted. Accordingly, we deny the exceptions.

112. In addition, we will address Enron's contention that the Commission determination in this case should preclude further challenges to its contracts with Nevada Power. In this order, we base our decision on the record in this proceeding and will not prejudge the Commission determination to be made in another proceeding involving Enron based on the record in that proceeding.

3. Miscellaneous Issues

113. Other issues litigated at the hearing were: (1) whether the Collateral Annex of the Snohomish-Morgan Stanley contract is contrary to the public interest; and (2) whether Merrill Lynch Capital Services (Merrill Lynch) or Allegheny was the real party in interest in the transactions identified in the Nevada Power's complaint against Allegheny. We address these issues below, as well as certain motions filed by Snohomish and SCWC.

A. Collateral Annex

114. Snohomish requests that the Commission either immediately terminate or substantially reform the Collateral Annex. In connection with this, Snohomish argues that the "just and reasonable" standard, rather than the "public interest" standard, applies to the evaluation of the Collateral Annex.

115. The ALJ found that by virtue of Section 35 of the WSPP Agreement,[186] the Collateral Annex is part of the WSPP Agreement and thus is governed by Section 6.1, which demonstrates the intent of the parties to disallow unilateral filings. The ALJ, therefore, concluded that the Collateral Annex is also subject to the "public interest" standard and thus will not be reformed.[187]

116. On exceptions, Snohomish and Staff assert as error the ALJ's determination regarding the Collateral Annex. Staff argues that the "public interest" standard does not apply in this case because the Commission never reviewed the amended Collateral Annex provision included in the Morgan Stanley-Snohomish contract, thus it has never been determined to be just and reasonable. For this same reason, Staff asserts that if the "public interest" standard is to be applied in this case, the Commission's more flexible standard is warranted.

117. Staff further asserts that because Section 39B of the contract limits the parties' rights to seek unilateral changes to "rates," it must be concluded that the parties did not intend to prohibit unilateral changes to such non-rate provisions as the Collateral Annex. Staff also argues that modification is

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[186] Section 35 of the WSPP Agreement provides in pertinent part: "...that all transactions, together with this Agreement and the related Confirmation Agreement(s) form a single, integrated agreement, and agreements and transactions are entered into in reliance on the fact that the agreements and each transaction form a single agreement between the Parties.

[187] Initial Decision at 65,313-15.

warranted because the Collateral Annex, by making Morgan Stanley the sole Valuation Agent, unduly favors Morgan Stanley at the expense of Snohomish.

118. Morgan Stanley states the Collateral Annex should not be subject to a modified, or "flexible," "public interest" standard. Morgan Stanley maintains that, consistent with the ALJ's finding, the WSPP Agreement, Confirmation Agreement, Attachment A, and the Collateral Annex form a single, integrated document, which is wholly subject to the *Mobile-Sierra* standard of review. Morgan Stanley states that although the Commission has at times expressed an intent to apply a standard that is more flexible than the "public interest" standard, that has only occurred under limited circumstances (such as when the subject contract is between affiliates and not the result of an arm's length negotiation) not present here.[188]

119. We affirm the ALJ's ruling. We find that the WSPP Agreement, Collateral Annex, Confirmation Agreement and Attachment A form a single, integrated agreement, which, as we held above, is to be reviewed under the "public interest" standard. Consistent with our conclusions above, Snohomish has failed to justify modification of the Collateral Annex.

B. Real Party in Interest

120. Allegheny asserts that it is not the right respondent in this case because the contracts

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[188] Morgan Stanley cites to Ne. Util. Serv. Co., 66 F.E.R.C. ¶ 61,3332 at 62,087-87 (1994).

submitted with Nevada Power's complaint list Merrill Lynch as the other counter party to the contracts. Initially, these contracts were executed by Merrill Lynch. Subsequently, Merrill Lynch and Allegheny entered into the Asset Contribution and Purchase Agreement (APA) pursuant to which Merrill Lynch transferred all of its rights, title, and interest in certain wholesale power sales agreements and associated books and records to Allegheny.[189] Allegheny, however, argues that the Nevada Power contracts were not assigned to Allegheny because Nevada Power never provided its written consent to the assignment, as required by Section 14 of the WSPP Agreement.[190]

121. In response, Nevada Power argues that the assignment of the contracts in question occurred pursuant to Section 14 of the WSPP Agreement because the transfer to Allegheny was to a successor in operation with comparable or higher creditworthiness.

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[189] Merrill Lynch Capital Serv., Inc., 94 F.E.R.C. ¶ 62,114 (2001).

[190] Section 14 of the WSPP Agreement covering a "Transfer of Interest in Agreement" states: "No party shall voluntarily transfer its membership under this Agreement without the written consent and approval of all other Parties except to a successor in operation of the applicable properties of such Party. With regard to the transfer of the rights and obligations of any Party associated with transactions under the Service Schedules, neither Party may assign such rights or obligations unless a) the other Party provides its prior written consent which shall not be unreasonably withheld; or b) the assignment is to a successor in operation whose creditworthiness is comparable to or higher than that of the assigning Party."

122. Allegheny argues that the parties' dealings after closing of the APA demonstrate that Allegheny is not the successor in operation to Merrill Lynch. In particular, Allegheny states that after the sale of assets, Merrill Lynch retained its status of a seller with respect to the contracts at issue and entered into the hedge contracts with Allegheny, whereby Allegheny would financially benefit from the Nevada Power contracts via a back-to-back hedge agreement. In addition, according to Allegheny, Nevada Power conducted business as though Merrill Lynch were the counterparty, as evidenced by Merrill Lynch's sending invoices to Nevada Power, which then made payment directly to Merrill Lynch. Allegheny further explains that Merrill Lynch's representations in the Section 203 application to the Commission for authorization of transfer of its jurisdictional facilities to Allegheny does not contradict Allegheny's position that no contract assignment has taken place. Allegheny contends that the parties intended to assign the Nevada Power contracts to Allegheny upon the closing of the APA, but then abandoned this intention when Nevada Power refused to sign a collateral agreement with Allegheny.

123. The ALJ found that the contracts were not assigned pursuant to the WSPP Agreement because Allegheny is not "a successor in operation" to Merrill Lynch. After closing of the APA, Merrill Lynch continued its wholesale electricity trading operation on a reduced basis. The ALJ further found that no assignment of the Nevada Power contracts occurred because Nevada Power did not consent to the assignment. As a result, in accordance with Section

5.05 of the APA, [191] Merrill Lynch acted as Allegheny's agent and trustee with respect to these contracts. The ALJ thus concluded that based on the nature of the Merrill Lynch-Allegheny relationship, Allegheny is the right respondent in this case because it is the principal, while Merrill Lynch is merely an agent.[192]

124. On exceptions, Allegheny claims that the ALJ misinterpreted the APA between Allegheny and Merrill Lynch. Nevada Power, however, asserts that the ALJ correctly found that the APA transferred the contracts to Allegheny. Nevada Power states that evidence of the transfer includes Allegheny's

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[191] Section 5.05 of the APA states: " If any consent for any agreement is not obtained and such agreement shall not be assigned, transferred, leased, subleased, licensed or sublicensed, the Sellers shall, to the extent possible without incurring any liability to any third party for which the Purchasers have not agreed to reimburse the Sellers, keep the agreement in effect (such agreements kept in effect are referred to herein as the "Seller Maintained Agreements") and to the extent reasonably possible give the Purchasers the benefit without limitation: (I) cooperating with the Purchasers in holding any rights under agreements for which no consent to assign rights to Purchaser is obtained ("Non-Assignable Rights") in trust for the Purchasers or acting as agent for the Purchasers; (ii) enforcing any rights of the Sellers arising from such Non-Assignable Rights against the issuers thereof or the other party or parties thereto; (iii) taking all such actions and doing, or causing to be done, all such things at the request of the Purchasers as shall be reasonably necessary and proper in order that the value of any Non-Assignable Rights shall be preserved and shall inure to the benefit of Purchasers; and (iv) paying over to the Purchase[r]s all monies or other assets collected by or paid to the Sellers in respect of such Non-Assignable Rights.

[192] Initial Decision at 65,328-32.

purchase of Merrill Lynch's entire wholesale electric energy trading business, including the Nevada Power contracts; the numerous representations made to the public, Merrill Lynch's customers and the Commission regarding the purchase; and Allegheny's performance under the contracts. In addition, Nevada Power states that whether Allegheny is the seller is irrelevant to whether the Commission has jurisdiction to determine the justness and reasonableness of the rates at issue here and the Commission's jurisdiction over the contracts in this case is not dependent on the identity of the parties currently before it.

125. We agree with Nevada Power that our decision to uphold these contracts does not depend on whether the seller for one of the contracts was Merrill Lynch or Allegheny. Moreover, since our decision to uphold the contracts means that we will not require refunds, this issue becomes moot and thus need not be addressed on the merits in this order.

4. Procedural Motions

A. Snohomish's Motion to Reopen the Record

126. Snohomish filed a motion to reopen the record to admit, or in the alternative, take official notice of the Staff Report on price manipulation in the Western markets; evidence submitted in the 100-Day Discovery Proceeding, the *Puget Sound*

proceeding in Docket No. EL01-10, *et al.*,[193] and the Enron investigation proceedings in Docket Nos. EL02-113, EL02-114 and EL02-115; and all public documents relating to the settlement in Docket No. IN01-3[194] and the public records from other pending Western forward contract proceedings.[195] Snohomish argues that the records of the above-listed proceedings contain substantial evidence that plainly contradicts the Initial Decision and the positions taken by the Respondents.

127. PUCN filed an answer in support of Snohomish's motion. PUCN also believes that the Commission should reopen the record or take official notice of evidence of market abuse submitted in other Western market proceedings. PUCN believes that evidence in those proceedings shows that manipulation and other market abuses negatively impacted forward prices. PUCN also suggests introducing in the record of the instant proceeding evidence produced in the Docket No. PA03-1-000,*et al.* proceeding.[196]

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[193] Puget Sound Energy, Inc. v. Jurisdictional Sellers of Energy, 101 F.E.R.C. ¶ 61,304 (2002), *order on clarification*, 102 F.E.R.C. ¶ 61,163 (2003).

[194] AES Southland, Inc. & Williams Energy Mktg & Trading Co., 95 F.E.R.C. ¶ 61,167 (2001).

[195] Pub. Utils. Com'n of Cal. v. Sellers of Long-Term Contracts to the Cal. Dep't of Water Resources, 99 F.E.R.C. ¶ 61,087 (2002), *order on reh'g*, 100 F.E.R.C. ¶ 61,098 (2002); and Pac.orp v. Reliant Energy Serv., Inc., *et al.*, 99 F.E.R.C. ¶ 61,381 (2002), *reh'g pending.*

[196] America Elec. Power Co., 103 F.E.R.C. ¶ 61,089 (2003) (directing submission of information with respect to internal processes for reporting trading data).

128. Indicated Sellers[197] and Morgan Stanley argue that there is no procedural basis for reopening the record because Snohomish has failed to show that an extraordinary change in core circumstances has occurred since the record was closed on October 24, 2002. Similarly, Indicated Sellers object to Snohomish's alternative request to take official notice of evidence from other proceedings. In their opinion, these materials are not subject to official notice because they are being contested. Indicated Sellers also argue that the Commission should not consider either reopening the record or taking official notice of evidence from other proceedings because addition of new material to the record in this proceeding will not change the outcome of this proceeding. Morgan Stanley adds that the information Snohomish seeks to introduce into the record of this proceeding is outside the scope of the instant proceeding and is irrelevant for determination of the issues being litigated. Morgan Stanley further argues that contrary to Snohomish's allegations, the phone transcripts submitted in the Docket Nos. EL02-60 and EL02-62 proceeding are not new evidence. According to Morgan Stanley, these transcripts were produced to Snohomish prior to the closing of the evidentiary record in the instant proceeding.

129. In its answer, Morgan Stanley included a motion requesting that the Commission impose sanctions on Snohomish for burdening Morgan

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[197] Indicated Sellers are comprised of Allegheny, BP, Calpine, Enron, Mirant, and Reliant. El Paso and Morgan Stanley support certain parts of the pleading.

Stanley and the Commission with its baseless motion to reopen the record. Snohomish responds that the imposition of sanctions is not warranted because Snohomish did not make false statement in its previous motion.

130. Snohomish and SCWC filed answers to Indicated Sellers' and Morgan Stanley's answers to Snohomish's motion. Morgan Stanley filed an answer to Snohomish's answer to its motion for sanctions. Answers to answers are generally not permitted pursuant to Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2), unless otherwise permitted by the decisional authority. We are not persuaded to allow these answers to answers.

131. The Commission may reopen the record in its discretion where there is good cause. [198] The Commission views good cause as consisting of extraordinary circumstances, that is, a change in circumstances that is more than just material, but goes to the very heart of the case. [199] In deciding whether to exercise its discretion, "the Commission looks to whether or not the movant has demonstrated the existence of extraordinary circumstances that outweigh the need for finality in the administrative process." [200] As the Commission

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[198] 18 C.F.R. § 385.716 (2003).

[199] CMS Midland, Inc., 56 F.E.R.C. ¶ 61,177 at 61,624, *reh'g denied*, 56 F.E.R.C. ¶ 61,361 (1991).

[200] E. Tex. Elec. Coop., Inc. v. Cent. & S. W. Serv., Inc., 94 F.E.R.C. ¶ 61,218 at 61,801 (2001) (denying reopening of record where movant sought to use actual data which became

explained in Opinion No. 238, "we recognize of course that changes have occurred since the close of the record. But such changes always occur.

Yet litigation must come to an end at some point. Hence the general rule is that the record once closed will not be reopened."[201]

132. The information now in the record provides a sufficient basis for our conclusions here. The evidence that Complainants seek to introduce into the record will not change the outcome of this proceeding, as more fully discussed above.

133. Now we turn to Snohomish's alternative request to take official notice of the Staff Report and evidence submitted in the proceedings specified by Snohomish. We find that Snohomish's request inasmuch it pertains to the Staff Report and 100-Day Discovery evidence to be moot because we have considered these findings and evidence as part of the record of this proceeding. As previously discussed, we conclude that, even if we assume that the allegations and findings contained in the Staff Report and the 100-Day Discovery Proceeding were true, they would not be determinative of the issues in this proceeding. However, we deny Snohomish's request to take official notice of evidence submitted in other proceedings. The records of those proceedings contain thousands of submittals, most of

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available after the close of the record in place of hypothetical data used at hearing).

[201] Transwestern Pipeline Co., Opinion No. 238, 32 F.E.R.C. ¶ 61,009 (1985), *reh'g denied*, Opinion No. 238-A, 36 F.E.R.C. ¶ 61,175 at 61,453 (1986).

which are case-specific and not relevant to the issues in the instant proceeding; the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.

134. We also deny Morgan Stanley's motion requesting imposition of sanctions on Snohomish. We do not find sanctions warranted in these circumstances.

B. SCWC's Motion to Lodge Oral Argument Exhibits

135. Subsequent to the April 23 oral argument, SCWC filed a motion to lodge the exhibits it presented during oral argument. SCWC contends that the oral argument exhibits should be lodged into the evidentiary record because they clarify certain statements made by SCWC at the April 23 oral argument. In response, Morgan Stanley argue that SCWC's motion should be denied because it does not meet the requirements necessary to reopen the evidentiary record under Rule 716 of the Commission's Rules of Practice and Procedure.[202]

136. SCWC's motion to lodge the oral argument exhibits is an attempt to reopen the evidentiary record of this proceeding to submit an additional exhibit that represents a new calculation. We are not persuaded that good cause exists to reopen the record. The need for finality in this proceeding outweighs the reasons put forward by Snohomish for reopening the record. Accordingly, we deny SCWC's

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[202] 18 C.F.R. § 385.716 (2003).

motion.

C. Snohomish's Motion to Stay

137. On May 30, 2003, Snohomish filed a motion to stay the instant proceeding pending the resolution of the complaint Snohomish filed in the U.S. District Court for the District of Columbia. In that complaint, Snohomish alleges that two members of the Commission violated the Sunshine Act [203] by conducting a private telephone conference on March 26, 2003. Snohomish's instant motion is based on the same allegations which the Commission rejected in the April 23, 2003 order addressing Snohomish's motion for recusal. [204] Accordingly, we deny Snohomish' request for stay.

The Commission orders:

(A) The Initial Decision is affirmed, as discussed in the body of this order.

(B) The complaints are hereby denied.

(C) Snohomish's and Senator Cantwell's requests for rehearing are hereby denied, as discussed in the body of this order.

(D) Snohomish's motion to reopen the record is hereby denied, as discussed in the body of this order.

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[203] 5 U.S.C. § 552(b) (2000).

[204] Nevada Power Co. & Sierra Pac. Power Co. v. Enron Power Mktg., Inc., 103 F.E.R.C. 61,080 (2003), *reh'g pending*.

(E) Snohomish's motion to take official notice is hereby denied in part and granted in part, as discussed in the body of this order.

(F) SCWC's motion to lodge is hereby denied, as discussed in the body of this order.

(G) Snohomish's motion to stay the proceeding is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Commissioner Massey dissented with a separate statement attached. Commissioner Brownell concurred with a separate statement attached.

s/ Magalie R. Salas
Magalie R. Salas
Secretary

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Nevada Power Company and
Sierra Pacific Power Company

Docket Nos. EL02-28-000
EL02-28-002
v. EL02-33-000
EL02-33-002
EL02-38-000
Enron Power EL02-38-002
Marketing, Inc.

El Paso Merchant Energy
American Electric Power Services, Corp.

Nevada Power Company

Docket Nos. EL02-29-000
EL02-29-002
EL02-30-000
EL02-30-002
v. EL02-31-000
EL02-31-002
EL02-32-000
Morgan Stanley EL02-32-002
Capital Group EL02-34-000
Calpine Energy Services EL02-34-002
Mirant Americas EL02-39-000
Energy Marketing, L.P. EL02-39-002
Reliant Energy Services
BP Energy Company
Allegheny Energy Supply Company, L.L.C.

Southern California Water Company

Docket Nos. EL02-43-000
v. EL02-43-002

Mirant Americas
Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

Docket Nos. EL02-56-000
v. EL02-56-002

Morgan Stanley Capital Group, Inc.

(Consolidated)

(Issued June 26, 2003)

MASSEY, Commissioner, *dissenting*:

I am dissenting from this order, not because I relish abrogating contracts because I do not, but because I believe this Commission has a higher calling than simply the sanctification of long term contracts with prices reaching as high as $290 per MWh, contract prices that were multiples of traditional prices, shockingly high prices, completely unprecedented by historic standards. Our primary calling under the Federal Power Act is to ensure that prices are just and reasonable 24 hours a day, seven days a week. When prices soar to unprecedented levels, when prices exceed a just and reasonable level by multiples, we have the obligation to make it

right. That is the way I read the law.

Many of the contracts challenged here provide for prices that are unlawful by any reasonable measure, and there is no persuasive public interest rationale for sanctifying contracts negotiated during the height of the Western electricity crisis, where the skyrocketing prices in an out of control spot market in California strongly influenced long term contract prices, wildly dysfunctional market conditions clearly allowed for the exercise of market power, and there was "epidemic" manipulation of the market according to our staff's Western Markets Report.

Protecting contracts entered into in this horribly tainted environment violates the Federal Power Act's forceful declaration that contracts are absolutely unlawful and must be reformed if not just and reasonable. Turning Commission policy on its head, today's order will encourage wholesale electricity purchasers to "ride the spot market" because the Commission has shown a willingness to mitigate, and provide refund protection from, unjust and unreasonable spot market prices, at least in the California spot markets.[1] By the same token, buyers will be discouraged from forward contracting because they will not enjoy protection from unlawful contract prices. Power buyers, consumers and retail policymakers will lose faith in the concept of wholesale electricity markets if they cannot trust the Commission to protect them from unjust and

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[1] In any case decided today, the Commission denies refund protection to spot market buyers in the Pacific Northwest during the crisis period. Puget Sound Energy, Inc., 103 F.E.R.C. ¶ 61,348 (2003).

unreasonable contract terms resulting from a wildly dysfunctional market, market power and epidemic market manipulation.

The J&R standard is the appropriate standard of review in this instance

One of the fundamental questions that must be addressed in evaluating whether a contract must be reformed is the standard of review. Where there is clear language in the contract indicating that the parties intended that the "public interest" standard must be met before terms may be modified, then that is the appropriate standard. Where the contract lacks a clear statement of intent, the correct standard to apply is not that clear. Today's order finds that the more stringent public interest standard must be satisfied even for contracts with no clear statement of intent. I do not agree.

It is my view that except where the contract has a *Mobile-Sierra* clause restricting the right of the buyer to file a section 206 complaint, the just and reasonable standard applies. I concede that the law in this area is not the model of clarity, and the argument that the public interest standard controls is not without merit. Nevertheless, I believe a customer's waiver of section 206 just and reasonable rights must be explicit. As the Commission observed in Order 888-A:

> We note that the fact that a contract may bind a utility to a *Mobile-Sierra* public interest standard does not necessarily mean that the customer is also bound to that standard. Unless a customer specifically

> waives its section 206 just and reasonable rights, the Commission construes the issue in favor of the customer.[2]

The Commission's proposed policy statement on standard of review is consistent with that position. The Commission would apply the just and reasonable standard of review unless specific language to the contrary is concluded in the contract.[3]

Perhaps more important, the just and reasonable standard should control the review of contracts negotiated *in the circumstances of this case* where the sellers were acting under a market-based pricing authorization granted by the Commission. The *Mobile-Sierra* doctrine arose in a cost-of-service regime. Once approved by the Commission as just and reasonable, a contract, rate or classification should not be modified unless a higher standard justifies the modification. This makes sense. Most cases arose in the context of a seller making a filing to justify a higher rate. In such a case, the doctrine appeared to have a customer protection rationale.

Today's order states that in a market based regime, the Commission's authorization for a public utility to sell at prices set by the discipline of the market, based upon a finding that the seller cannot exercise or has mitigated market power, amounts to

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[2] Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997) at 30, 191, footnote 31.

[3] Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 100 F.E.R.C. ¶ 61,145 (2002) at para. 7.

a "predetermination" that any contract negotiated by such seller is just and reasonable. Hence, according to the majority, the just and reasonable standard of section 205 is satisfied, and a later contract modification would have to be justified by the higher public interest standard.

There are three flaws in this logic as applied here. First, virtually all of the Commission's orders granting market based pricing authority to the public utility sellers in the West explicitly declared that the Commission's action could not be construed as approving any contract negotiated pursuant thereto. These orders say:

> (t)his action does not constitute approval of any service, rate, charge, classification . . . or any . . . contract . . . affecting such rate or service..., nor shall such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding . . .

Based upon this language, it seems clear that these contracts have never been approved as just and reasonable under section 205.

Second, even ignoring the rather plain language of the above-quoted paragraph, any possible presumption of the justness and reasonableness of contracts negotiated pursuant to the blanket authorization was flatly contradicted by the conclusions reached in the Commission's

November 1, 2000 and December 15, 2000 orders, and in the July 2001 order requiring refunds. The November order found the market in California to be seriously flawed, and market conditions "have caused and continue to have the potential to cause, unjust and unreasonable rates for short term energy." Further: "There is clear evidence that the California market structure and rules provide the opportunity to exercise market power when supply is tight and can result in unjust and unreasonable rates."[4] In the December 15 order the Commission said that "we reaffirm our findings that unjust and unreasonable rates were charged and could continue to be charged, unless remedies are implemented."[5] It should be clear from both the breathtaking rise in prices after the December order and the June 2001 intervention by the Commission that the remedies in the December order did not work. Effective remedies were not put in place until June 2001 when the Commission imposed full time price controls. I would also note that the Commission's grant of market based pricing authority "depends on a functioning competitive market...unimpaired by market manipulation." Implicit in the grant of such authority is "a presumption that a company's behavior will not involve fraud or deception."[6] Circumstances indicate that this condition and presumption were not fulfilled. The Commission has

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[4] San Diego Gas & Elec. Co., 93 F.E.R.C. ¶ 61,121 (2000) at 61,349.

[5] San Diego Gas & Elec. Co., 93 F.E.R.C. ¶ 61,294 (2000) at 61,999.

[6] Reliant Energy Servs., 102 F.E.R.C. 61,315 (2003) at para. 12; and Enron Power Mktg. Inc., 102 F.E.R.C. ¶ 61,316 (2003).

found evidence of market manipulation in the California markets and is also investigating whether sellers withheld power from the market or engaged in excessive bidding.

In light of all of these circumstances, the predetermination rationale is without merit. The Commission's July 2001 order granting refunds for a nine month period beginning October 2, 2000 and ending June 19, 2001 was based upon a finding that during such period spot prices were not just and reasonable. It defies logic to rely upon a "predetermination" of justness and reasonableness contradicted by later Commission orders that reviewed real market conditions, found the opportunity to exercise market power, and required several billions of dollars in refunds based upon the explicit conclusion that actual prices charged in fact were not just and reasonable.

Third, the rates charged by sellers in the California spot markets were under the same regulatory scheme that produced the forward contracts at issue here, i.e., a preliminary finding at the certificate stage that a seller lacked or had mitigated market power and, hence, rates sought to be charged by such seller would by definition be just and reasonable. This "predetermination" applied equally to spot prices and to long term contract prices. Yet, in July 2001 the Commission wisely and correctly decided to apply the just and reasonable standard to justify modifying the California spot prices and ordering refunds. Satisfying the public interest standard was not required. The Commission did not protect unjust and unreasonable spot prices (which were derived under tariff conditions and are

akin to hourly contracts), yet decides today to protect unjust and unreasonable longer term transactions negotiated under the same regulatory framework. This distinction in the standard of review, based solely upon the length of the transaction, does not comply with sections 205 and 206 of the Act, and in my view is not reasoned decision making.

There is an additional reason that the just and reasonable standard should govern in this case. It is obvious that the buyers detrimentally relied upon the Commission's admonition in the December 2000 order that market participants enter into long term contracts.[7] In that same order, the Commission assured buyers that they would be protected from the exercise of market power. The Commission set a $74 MWh benchmark to use "in assessing any complaints regarding the justness and reasonableness of pricing of such long-term contracts negotiated under current market conditions."[8] The Commission promised to monitor prices "to address concerns about potentially unjust and unreasonable rates" in the long term markets.[9]

The buyers reasonably relied upon the Commission's declaration that complaints about long term contracts would be judged according to just and reasonable standards and they would be protected.

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[7] "...those who remain in the spot market for buying their residual load or selling their residual supply should be there in full recognition of the effects on price of last minute sales and purchases." 93 F.E.R.C. at 61,996.

[8] 93 F.E.R.C. at 61,982.

[9] 93 F.E.R.C. at 61,994.

Given that reliance, it is simply unfair to adopt a standard of review today that gives these buyers substantially less protection. In addition, after the Commission declared in December 2000 that $74 MWh was a just and reasonable benchmark for long term contracts negotiated thereafter, it seems unconscionable now to validate contracts that allowed sellers to fetch upwards of $250 MWh, $260 MWh, and $290 MWh -- multiples of the benchmark. The Commission effectively said to buyers "get into long term contracts, $74 is a reasonable benchmark price and, hey, don't worry, we'll protect you from unjust and unreasonable contract prices." Today's order utterly fails to keep that commitment.

The nexus between the California spot market and the forward contract market

A second fundamental issue in this case is whether the dysfunctional California spot markets adversely affected the long-term bilateral markets. I frankly do not understand why the hearing order in this case treated this as an open issue, and I said so at the time. The relationship between the spot market prices and long term contract prices seems rather obvious, and the Commission has explicitly recognized that "maintaining an accurately priced spot market is the single most important element for disciplining longer term transactions." [10] In our Standard Market Design proposal, the Commission found that:

Bilateral contracts generally reflect buyer and

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[10] AEP Power Mktg., 97 F.E.R.C. ¶ 61,219 (2001) at 61,972.

> seller expectations of prices in spot markets. Therefore, market power mitigation in the organized spot market will effectively discipline market power in the bilateral markets as well [*footnote omitted*].[11]

More to the point, the Commission has specifically recognized the relationship between the California spot markets and bilateral markets in the West. Our November 1, 2000 order stated:

> Therefore, the operation of the California electricity market can affect prices throughout the entire Western Interconnection. The Staff Report demonstrates that during the summer of 2000 correlations between PX prices and Western bilateral prices were quite strong.[12]

And our June 19, 2001 mitigation order recognizes that "(t)here is a critical interdependence among the prices in the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward markets."[13] Thus, it is beyond comprehension why there is any doubt on this issue.

But if there was any doubt whatsoever regarding whether there was a nexus between the spot and forward markets, the staff's Western Markets Report should dispel it. Staff's analysis

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[11] Standard Mkt. Design NOPR, 100 F.E.R.C. ¶ 61,138 (2002) at para. 405.

[12] 93 F.E.R.C. at 61,357 to 358.

[13] San Diego Gas & Elec. Co., 95 F.E.R.C. ¶ 61,418 (2001) at 62,547.

found that there was a statistically significant relationship between spot and forward power prices during the period January 1, 2000 through June 30, 2001.[14] The contracts at issue here were negotiated during this time period. The Commission should respect staff's analysis. It was performed by a nationally recognized econometrician with a specialty in energy futures markets and with access to the most comprehensive database of forward power contracts for the period and locations in question. Thus, based on logic, the Commission's prior statements, and the conclusions of our staff's strong analysis, it is beyond dispute that the prices and other terms of the forward contracts at issue here were influenced by the California spot markets.

The just and reasonable standard is met

The prices and other terms of the forward contracts at issue here are unjust and unreasonable and should be reformed. I base this conclusion on three factors. First, the Commission has found that the California spot markets resulted in unjust and unreasonable rates for the refund period (October 2, 2000 to June 19, 2001). This is the period during which the contracts at issue here were negotiated. Second, the California markets were subjected to various forms of manipulation, which may have included withholding.[15] Third, there was a clear

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[14] Western Markets Report at VI-18.

[15] See Enron Power Marketing., Inc., 103 F.E.R.C. ¶ 61,343 (2003) where the Commission revokes the market-based authorities and terminates the blanket marketing certificates of various Enron affiliates. See also American Electric Power Service Cos., 103 F.E.R.C. ¶ 61,345 (2003), Enron Power

nexus between the California spot market and the forward contract markets. The unlawful California spot prices strongly influenced forward contract prices. And fourth, the prices in many of these contracts are multiples of the $74 MWh price the Commission had declared would be used as a rough just and reasonable benchmark.

The public interest standard is met

Even if the majority is correct and the appropriate standard of review is the public interest standard, these agreements still do not withstand scrutiny and must be reformed. The tone of today's order is that the *Mobile-Sierra* line of cases places a thumb heavily on the scale in favor of sanctity of contracts, and thus sets an exceptionally high threshold in meeting the public interest standard. While the threshold may be high, it is not as high as today's order would place it for the particular contracts at issue.

The *Mobile-Sierra* case law involves contracts negotiated under a cost of service regime, and thus we do not know how the courts would instruct the Commission to address contracts negotiated in a market-based regime, especially under market conditions characterized by dysfunctional market rules, widespread manipulative conduct, and a lack of effective regulatory oversight. We are on new ground here, and the Commission is free to decide

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Marketing, Inc. (2003) and Investigation of Anomalous Bidding Behavior & Practices in the Western Markets, 103 F.E.R.C. ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

what circumstances give rise to the public interest.[16] We are clearly not limited to the traditional three-prong test that gets so much attention. Today's order as well as court precedent point out that those three factors are only examples of what to consider in determining the public interest. [17] Indeed, the Commission has great discretion in carrying out its statutory responsibilities, even where the public interest standard controls:

> . . . even if contracts fall within the scope of the *Mobile-Sierra* decisions, the Supreme Court has emphasized that the relevant agency, here FERC, may always reform a contract found to be 'unlawful" or 'contrary to the public interest,' i.e., that "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest."[18]

The Commission's order setting this case for hearing implicitly recognized our discretion in evaluating these contracts under the public interest

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[16] "...nowhere in the Supreme Court opinion is the term 'public interest' defined. Indeed, the Court seems to assume that the Commission decides what circumstances give rise to the public interest." Northeast Utils. Serv. Co. v. FERC, 55 F.3d 686, 690 (1st Cir. 1995).

[17] "This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." Northeast Utils., 55 F.3d at 690. Also see today's order at para. 6.

[18] Northeast Utils., 55 F.3d at 693.

standard when it held that "the Commission will not modify market based contracts unless there are extraordinary circumstances."[19] We are instructed by the courts that "(w)hen there is no reason to question what occurred at the contract formation stage, the parties may be required to live with their bargains." [20] What's at issue then is rendering judgement regarding whether there were extraordinary circumstances at play during the contract formation stage that warrant contract reformation.

In evaluating whether to reform contracts involving a seller with market-based authority, we must be guided by the market circumstances that affected the negotiations and contract terms. It has already been established that the conditions in the California markets infected markets across the West, including the forward contracts, such as those at issue in this case. What were the circumstances under which buyers negotiated these contracts?

- The structure and rules of California markets were flawed, market power could be exercised in them, unjust and unreasonable rates had been charged and the potential existed that unlawful rates could be charged in the future. This is what the Commission found in November and December of 2000.

- Due to a combination of factors, there was a

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[19] Nev. Power Co. & Sierra Pac. Power Co., v. Enron Power Mktg., Inc., 99 F.E.R.C. ¶ 61,047 (2002) at 61,190

[20] Norwood v. FERC, 587 F.2d 1306, 1312 (D.C. Cir. 1978).

shortage of electricity that resulted in unprecedented, high, volatile, and unjust and unreasonable prices in the spot markets. As a result, the Commission admonished buyers to move load into forward contracts or suffer the consequences.

- The electricity market during this same time frame was manipulated through a number of strategies by sellers. These are documented in the Western Markets Report and in orders decided today where the Commission requires more than fifty power sellers to defend against charges that they engaged in one or more manipulative strategies to pump up electricity prices.[21] The Commission is still investigating whether generation was strategically withheld from the market.

- During this same time frame, the price of natural gas, the fuel input for the marginal generation resources in the West, was manipulated by epidemic false reporting. This is documented in the Western Markets Report.

- As prices soared out of control, buyers had no basis to expect that this Commission would act forcefully to control them. The measures imposed in the December 2000 order were clearly

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[21] See American Electric Power Service Cos., 103 F.E.R.C. ¶ 61,345 (2003), Enron Power Marketing, Inc. (2003) and Investigation of Anomalous Bidding Behavior & Practices in the Western Markets, 103 F.E.R.C. ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

ineffective and prices continued to rise. The Commission approved as just and reasonable spot prices of $273 MWh, $430 MWh and $300 MWh for the first three months of 2001, respectively,[22] and the Commission's then chairman reportedly advised Californians at the time that the only way out of the crisis was to "start putting shovels in the ground."[23]

This is the unprecedented environment in which these contracts were negotiated. The economic signals that formed the basis of the negotiations, and consequently the contract terms, were severely tainted. Buyers had their backs to the wall under these circumstances and essentially negotiated out of fears of yet higher prices or blackouts for their customers. Such conditions, spread over an area as large as the western United States, are truly extraordinary. And those conditions had extraordinary effects. For example:

- This Commission found it necessary in June 2001 to cap prices across this entire thirteen state region, 24 hours a day, seven days a week.[24] Such broad market intervention by this agency was unprecedented.

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[22] See, respectively, 94 F.E.R.C. ¶ 61,245 (2001), 94 F.E.R.C. ¶ 62,245 (2001), and an unpublished Notice of Proxy Price for April Wholesale Transactions in the California Wholesale Electric Market issue by the Director, Office of Markets, Tariffs and Rates, April 16, 2001.

[23] Statement attributed to Chairman Hebert, San Francisco Chronicle, April 12, 2001 (as reported on the San Francisco Chronicle's web site -- www.sfgate.com.)

[24] San Diego Gas & Elec. Co., 95 F.E.R.C. ¶ 61,418 (2001).

- A major California utility, Pacific Gas and Electric, declared bankruptcy as a direct result of the crisis and a second utility, Southern California Edison, teetered on the edge of bankruptcy.

- Local economies suffered devastating effects as a result of these market conditions. In the Pacific Northwest, factories closed and jobs were lost. The aluminum industry has exited the region for all intents and purposes.

- The movement toward competitive electricity markets at the national and state levels was almost brought to a halt. Consumers and policymakers were shocked and outraged that an out of control electricity market could wreak such havoc.

The tainted atmosphere in which these contracts were negotiated was unprecedented and extraordinary. The most influential benchmark used in negotiating forward contracts -- the spot market and expectations of future spot prices -- was wildly dysfunctional. When these contracts were negotiated, the Commission had already declared that conditions in the California markets allowed the exercise of market power and rates were unjust and unreasonable. And we now know that there was unprecedented manipulation of both the natural gas and electricity markets and epidemic false reporting of natural gas trading data.

There is simply no persuasive public interest rationale for protecting and sanctifying contracts

negotiated in this unprecedented and extraordinary environment. Those market conditions certainly tainted any contracts negotiated during this time frame. It would simply defy logic to conclude that the high prices in these contracts were not adversely influenced by market conditions that included the exercise of market power and widespread market manipulation. Upholding such contracts violates the public interest. These contracts must be reformed.

Remedy

I would remand this case to an Administrative Law Judge to determine specifically how each contract should be reformed. I would also recommend that the judge use the method set out in staff's Western Markets Report for determining the mitigated price in each contract. I suggest this method because staff's analysis has great credibility -- it had access to the most comprehensive data base of forward price contracts for the period and locations in question.

Staff's econometric analysis estimates the statistical relationship between spot power prices and forward contract prices (the "spot power elasticity"). This relationship shows how much forward prices rise for each percentage increase in spot prices. Staff also developed a formula representing the relationship between the degree to which spot power prices were excessive and the appropriate level for mitigated forward prices. This formula can be used to set mitigated forward contract prices. The excessiveness of spot prices (or the "spot power distortion" in staff's formulation) can be estimated by using the mitigated market clearing

prices (MMCPs) being developed in the California refund proceeding. The MMCPs will represent the just and reasonable prices in the California spot markets. The spot power distortion can then be plugged into staff's formula to develop the mitigated forward prices.[25]

For these reasons, I dissent from today's order.

s/ William L. Massey
William L. Massey
Commissioner

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[25] See Western Markets Report, V-16 to V-18.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Nevada Power Company and
Sierra Pacific Power Company

Docket Nos. EL02-28-000
EL02-28-002
v. EL02-33-000
EL02-33-002
EL02-38-000
Enron Power EL02-38-002
Marketing, Inc.

El Paso Merchant Energy
American Electric Power Services, Corp.

Nevada Power Company

Docket Nos. EL02-29-000
EL02-29-002
EL02-30-000
EL02-30-002
v. EL02-31-000
EL02-31-002
EL02-32-000
Morgan Stanley EL02-32-002
Capital Group EL02-34-000
Calpine Energy Services EL02-34-002
Mirant Americas EL02-39-000
Energy Marketing, L.P. EL02-39-002
Reliant Energy Services
BP Energy Company
Allegheny Energy Supply Company, L.L.C.

Southern California Water Company

Docket Nos. EL02-43-000
v. EL02-43-002

Mirant Americas
Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

Docket Nos. EL02-56-000
v. EL02-56-002

Morgan Stanley Capital Group, Inc.

(Consolidated)

(Issued June 26, 2003)

BROWNELL, Commissioner, concurring

1. I have been very clear in my prior statements about my belief in the sanctity of contracts. However, the issue of how to weigh contract sanctity in the context of the Western power crisis is, to say the least, a very difficult one, and I have struggled with it. The parties in this case were afforded the opportunity of a trial-type hearing and I have reviewed the evidence developed during that hearing. I have read the ALJ's Initial Decision and considered the parties' briefs on that Decision. I have also reviewed Staff's Final Report on Price Manipulation in Western Markets and the evidence submitted in the 100-Day Discovery Proceeding in

the context of this case. Finally, the Commission took the unusual step of providing the parties an additional opportunity to address the issues in an oral argument before the Commission itself, and I have carefully considered all points raised during that oral argument. After reviewing all of this information, I agree with the order's conclusion that these were contracts voluntarily entered into and the Complainants have not met their burden of proving that the contracts are contrary to the public interest.

2. I am writing separately to express my concern about one aspect of the order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the contracts' silence as to the buyer's right to seek unilateral changes under section 206.[1] Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest

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[1] Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing L.L.C., *et al.*, 99 FERC ¶ 61,042 (2002) (citing Texaco Inc. v. FERC, 148 F.3d 1091, 1096 (D.C. Cir. 1998) and Boston Edison Co. v. FERC, 233 F.3d 60, 607 (1st Cir. 2000)).

standard.[2]

3. This order could have simply affirmed the ALJ's conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do. Unfortunately, today's order fails to do so and instead bases the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The *Mobile-Sierra* doctrine is not an invention of the FERC that we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the parties' intent in future contract abrogation cases.

s/ Nora Mead Brownell
Nora Mead Brownell

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[2] Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, *et al.*, 102 FERC ¶ 63, 013 at P 28 (2003); Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., *et al.*, 101 FERC ¶ 63,031 at P27 (2002); and PacifiCorp v. Reliant Energy Services, Inc., *et al.*, 102 FERC ¶ 63,030 at P 18 (2003).

APPENDIX Q

103 FERC ¶ 61,354

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Public Utilities Commission of the State of California	Docket Nos. EL02-60-000 and EL02-60-003
v.	
Sellers of Long Term Contracts to the California Department of Water Resources California Electricity Oversight Board	
v.	
Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources	Docket Nos. EL02-60-000 and EL02-60-003
	(Consolidated)

ORDER ON PARTIAL INITIAL DECISION, REMAINING SUBSTANTIVE ISSUES AND MOTIONS

(Issued June 26, 2003)

1. This proceeding involves complaints by which customers under certain long-term contracts sought to modify those contracts with more than twenty-four (24) sellers. As a result of withdrawals, only seven sellers remain in this proceeding. The Public Utilities Commission of the State of California (CPUC) and the California Electricity Oversight Board (CEOB) (collectively, "Complainants") allege that the prices, terms and conditions of long-term contracts entered into between the California Department of Water Resources (CDWR) and a group of sellers of energy are unjust and unreasonable and, to the extent applicable, not in the public interest. Complainants seek that the contracts be voidable, at the option of the State of California, or be abrogated.

2. In the order issued on April 25, 2002,[1] the Commission set the instant complaints for hearing. On January 16, 2003,[2] after an evidentiary hearing, the Administrative Law Judge (ALJ) concluded that the applicable standard of review intended by the parties for the contracts at issue here is the "public interest" standard.[3]

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[1] Public Utilities Commission of California v. Sellers of Long Term Contracts, 99 F.E.R.C. ¶ 61,087 (2002) (April 25 Order).

[2] Public Utilities Commission of California v. Sellers of Long Term Contracts, 102 F.E.R.C. ¶ 63,013 (2003) (Partial Initial Decision).

[3] *See* United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) (Mobile); FPC v. Sierra Pacific Power, 350 U.S. 348 (1956) (Sierra); and United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div., 358 U.S. 103 (1958).

3. In this order, we affirm the ALJ's finding that the "public interest" standard of review applies to all the contracts at issue which did not contain explicit *Mobile-Sierra*[4] language. We also find that Complainants have not met their burden of proof under the "public interest" standard to justify the modification or abrogation of the contracts at issue in this proceeding. Thus, we deny the complaints. In denying the instant complaints, we have considered the evidentiary record developed in this proceeding, findings of the Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report), and evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95, *et al.*[5]

4. Specifically, we affirm the ALJ's finding that the applicable standard of review for the contracts at issue here is the "public interest" standard. Before discussing the specific facts of the case before us, it is important to understand the historical context in which the "public interest" standard has been applied by the courts, and the legal parameters within which the Commission must address requests for contract reformation. The "public interest" standard of review was first introduced by the U.S. Supreme Court in the 1956 *Mobile* case[6] and the concurrently decided *Sierra*

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[4] *Mobile*, 350 U.S. 332; *Sierra*, 350 U.S. 348.

[5] San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv., 101 F.E.R.C. ¶ 61,186 (2002) (November 20 Order), *order on clarification and reh'g*, 102 F.E.R.C. ¶ 61,164 (2003) (February 10 Order).

[6] *Mobile*, 350 U.S. 332.

case.[7] The U.S. Supreme Court held that, in order to justify modification of its contract, the seller in that case had to show that the contract rate was so low that it was contrary to the public interest. In the *Mobile* and *Sierra* decisions, the Court sought to mesh the respect for the sanctity of contracts under the Federal Power Act (FPA)[8] and Natural Gas Act[9] with the traditional scheme of regulation under these statutes. The Court held that, where the public utility (or natural gas company) and its customer contracted for a particular rate and did not reserve for the seller the right to unilaterally propose a rate change, the utility cannot unilaterally (*i.e.*, without the customer's consent) file a new rate under Section 205 of the FPA[10] to supersede the agreed-upon rate. The Court also ruled that the Commission's power under Section 206 of the FPA[11] to alter the existing contract rate, after its acceptance by the Commission, is limited.[12]

5. In the *Sierra* decision, the Court gave examples of factors that would meet the "public interest" standard and allow the selling utility to modify its contract. The selling utility was required to demonstrate, for example, that "the rate is so low as to adversely affect the public interest -- as where it might impair the financial ability of a public utility to

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[7] *See Sierra*, 350 U.S. 348.

[8] 16 U.S.C. §§ 796 *et seq.* (2000).

[9] 15 U.S.C. §§ 717 *et seq.* (2000).

[10] 16 U.S.C. § 824d (2000).

[11] 16 U.S.C. § 824e (2000).

[12] Boston Edison Co. v. F.E.R.C., 233 F.3d 60, 64-65 (1st. Cir. 2000) (*Boston Edison*) (citing *Sierra*, 350 U.S. at 352-55; accord *Mobile*, 350 U.S. at 347).

continue service, cast upon other consumers an excessive burden, or be unduly discriminatory."[13]

6. Both *Mobile* and *Sierra* addressed seller challenges to contract rates alleged to be too low. In later cases, the *Mobile-Sierra* doctrine was applied to contracts containing rates that allegedly were too high.[14] The *Mobile* and *Sierra* cases were decided in a cost-based rate regime and consequently dealt with changes proposed to contracts that were already on file with the Commission. The application of the *Mobile-Sierra* doctrine was later extended to contracts that were not on file with the Commission.[15]

7. In a more recent case involving a long-term, fixed-rate contract, the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest'] standard."[16] In *PEPCO*, the court also noted that the purchaser seeking a lower rate failed to "offer any evidence (beyond speculation) that the only potential non-parties here, its ratepayers, were adversely affected by the existing rates; it did not, for example,

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[13] *See Sierra* at 355.

[14] *See, e.g.*, Public Service Commission of the State of New York v. FPC, 543 F.2d 757, 798 (D.C. Cir. 1974).

[15] *See, e.g.*, Richmond Power & Light v. FPC, 481 F.2d 490, 493 (D.C. Cir. 1973) (holding that "the contract between the parties governs the legality of the filing. Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."). Borough of Lansdale, Pennsylvania v. FPC, 494 F.2d 1104, 1112 (D.C. Cir. 1974).

[16] *See* Potomac Electric Power Company v. F.E.R.C., 210 F.3d 403, 404 (D.C. Cir. 2000) (*PEPCO*).

even attempt to show how much if any of the rate disparity was passed on to PEPCO ratepayers rather than borne by the utility itself."[17] While PEPCO claimed an excessive burden on its customers and discriminatory impact from the disparity between the contract rates and the OATT rate charged by the same transmission provider, the court said that "other than pointing out that the contract rate is twice [Allegheny's] OATT rate, [PEPCO] has presented no evidence regarding how the contract rates are unduly discriminatory or excessively burdensome on PEPCO ratepayers."[18] The court noted the Commission's precedent which holds that "the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to the public interest."[19]

8. Based upon our review of the evidence and the totality of circumstances, we conclude that the Complainants have failed to meet their burden of proof under the "public interest" standard, as defined in past cases. We find that the challenged contracts are not contrary to the public interest because the

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[17] *Id.* at 408.

[18] *Id.* at 409.

[19] *See, e.g.*, Gulf States Utilities Company v. Southern Company Services, Inc., *et al.*, Opinion No. 300, 43 F.E.R.C. ¶ 61,003 at 61,016, *reh'g denied*, Opinion No. 300-A, 43 F.E.R.C. ¶ 61,394 (1988), *aff'd sub nom.* Gulf States Utilities Company v. F.E.R.C., 886 F.2d 442 (1989); *accord* Soyland Power Cooperative, Inc. v. Central Illinois Public Service Company, 51 F.E.R.C. ¶ 61,004 at 61,014-15 (*Soyland*), *reh'g dismissed as moot*, 52 F.E.R.C. ¶ 61,149 (1990); Public Service Company of New Mexico, 43 F.E.R.C. ¶ 61,469, at 62,152, *reh'g denied*, 45 F.E.R.C. ¶ 61,034 (1988), *aff'd sub nom.* San Diego Gas & Electric Company v. F.E.R.C., 904 F.2d 727 (D.C. Cir. 1990) (*San Diego*).

Complainants have failed to demonstrate that the contracts in question caused financial distress for the Complainants, threatening their ability to continue service, that the contracts cast an excessive burden on customers, that the contracts were unduly discriminatory to the detriment of other customers that are not parties to this proceeding, or that any other factors on this record demonstrate that the contracts are contrary to the public interest. At the time of contract execution, other alternatives were available to the Complainants; however, they chose to enter into the contracts in question, accepting market risks. Complainants benefitted from resales of the energy purchased under these contracts during the relevant period; however, after the drop in prices, Complainants became dissatisfied with their bargains and sought contract modification. The law is quite clear on that point. The fact that a contract becomes uneconomic over time does not render it contrary to the public interest. We, therefore, deny the instant complaints.

9. This order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the *Mobile-Sierra* doctrine.

I. Background

10. On February 25, 2002, Complainants filed separate, but virtually identical, complaints seeking to modify thirty (30) contracts.[20] The contracts at issue

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[20] The contracts which were set for hearing were listed in April 25 Order, 99 F.E.R.C. at Appendix A and are provided herein in Appendix A.

are long-term contracts between the California Department of Water Resources (CDWR) and more than twenty-four (24) sellers[21] of energy.

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[21] The complaints were filed against the following Respondents: Allegheny Energy Supply Company, LLC (Allegheny); Calpeak Project Companies; Calpine Energy Services, L.P. (Calpine); Clearwood Electric Company, LLC (Clearwood); Colton Power, L.P. (Colton), successor in interest to Alliance Colton, L.L.C. (Alliance); Constellation Power Source, Inc. (Constellation); Coral Power, L.L.C. (Coral); Dynegy Power Marketing, Inc. (Dynegy); El Paso Merchant Energy, L.P. (El Paso); Fresno Cogeneration Partners, LP (Fresno); GWF Energy LLC (GWF Energy); High Desert Power Project, LLC (High Desert); Imperial Valley Resource Recovery Company, L.L.C. (Imperial Valley) and Primary Power International (Primary Power), agents for Imperial Valley (collectively, IVRRC); Mirant America Energy Marketing, LP (Mirant); Morgan Stanley Capital Group, Inc. (Morgan Stanley); Pacificorp Power Marketing, Inc. (PPM); PG&E Energy Trading-Power, LP (PG&E Energy); Sempra Energy Resources (Sempra); Soledad Energy, LLC (Soledad); Sunrise Power Company, LLC (Sunrise); Wellhead Power Gates LLC and Wellhead Power Panoche LLC (Wellhead Companies); Williams Energy Marketing & Trading Company (Williams); and Whitewater Energy Corporation (Whitewater).

Complainants have withdrawn their complaints with the majority of the Respondents. Notices of withdrawal of complaints with prejudice were filed as to: (1) Whitewater on May 1, 2002; (2) Calpine on May 1, 2002 and May 2, 2002; (3) Constellation and High Desert on May 2, 2002 and May 6, 2002; (4) CalPeak Power – Midway LLC, CalPeak Power – Mission, LLC, CalPeak Power – Panoche LLC, CalPeak Power - Border LLC, CalPeak Power – Vaca Division LLC, CalPeak Power – El Cajon LLC and CalPeak Power – Enterprise LLC on May 20, 2002 and May 21, 2002; (5) Soledad on July 12, 2002; (5) GWF Energy on September 4, 2002 and September 5, 2002; (6) Alliance and Colton on September 30, 2002 and October 1, 2002; (7) PG&E Energy on October 3, 2002; (8) Sunrise on January 13, 2003. No motions in opposition to the notices of the withdrawal were filed, and the Commission took no action to disallow the withdrawal. Accordingly, pursuant to Rule 216 of the Commission's Rules of Practice and Procedure, 18 CFR § 385.216(b) (2003), the withdrawals became effective at the end of

Complainants claimed that the prices, terms and conditions of these contracts are unjust and unreasonable and, to the extent applicable, not in the public interest. Complainants also alleged that these sellers obtained the prices, terms and conditions in the contracts through the exercise of market power in violation of the Federal Power Act (FPA) and that the sellers' actions were causing injury to the citizens and ratepayers of California.

11. On April 25, 2002, the Commission dismissed the complaints regarding the contracts that were entered into after June 20, 2001, "the date on which the Commission's West-wide mitigation went into effect, . . . since the effect of the West-wide mitigation was to stabilize prices."[22] The Commission set for hearing the complaints regarding the contracts entered into before June 20, 2001. The Commission limited the evidentiary hearing to determining:

> whether the dysfunctional California spot markets[23] adversely affected the long-term bilateral markets, and, if so, whether modification of any individual contract at issue is warranted. The

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15 days from the date of the filing of the notices. The notice of withdrawal of the complaints as to Williams is granted, as discussed below.

[22] April 25 Order, 99 F.E.R.C. ¶ 61,087.

[23] In this context, spot markets or spot market sales are sales that are 24 hours or less and that are entered into the day of or day prior to delivery. *See* San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, 96 F.E.R.C. ¶ 61,120 at 61,515 (2001); San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, 95 F.E.R.C. ¶ 61,418 at 62,545 n.3 (2001).

> hearing will not address issues concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority. Further, if the judge concludes that modification of one or more of the contracts is warranted, the judge should not attempt at this stage to determine how those contracts should be modified.[24]

12. The Commission differentiated this evidentiary hearing from the staff investigation of potential manipulation of electric and natural gas prices in the West. The Commission stated that:

> By order issued on February 13, 2002 [in Docket No. PA02-2-000], the Commission directed a staff investigation of potential manipulation of electric and natural gas prices in the West. We are setting the instant contracts for hearing under Section 206 of the FPA based on the arguments that the dysfunctional spot markets in California caused long-term contracts not to be reasonable, whereas the investigation is looking at whether there was improper behavior by sellers that may have caused prices not to be reasonable.[25]

13. In addressing the standard of review to be applied to the contracts at issue, the Commission

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[24] April 25 Order, 99 F.E.R.C. at 61,384.

[25] April 25 Order, 99 F.E.R.C. at 61,383, n.28.

reiterated its long-standing policy of upholding the sanctity of contracts and stated that it would not modify market-based contracts absent extraordinary circumstances.[26] The Commission determined that the contracts that contained explicit *Mobile-Sierra* language would have to satisfy the *Mobile-Sierra* "public interest" standard of review to justify modification of the contracts. The parties whose contracts contained explicit *Mobile-Sierra* language include: Allegheny; Mirant; and Coral. The Commission ruled that it needed additional information in order to determine the applicable standard of review for the contracts that did not contain an explicit *Mobile-Sierra* provision. The parties whose contracts did not contain explicit *Mobile-Sierra* language include: El Paso; Dynegy; Morgan Stanley; and Sempra. In its January 23, 2002 Order on Rehearing, the Commission stated that "[t]he evidentiary hearing was established to, among other things, interpret the terms of [the contracts at issue] and to ascertain the intent of the parties at the time these contracts were signed."[27]

14. In the July 23 Order, the Commission affirmed its dismissal of the complaints related to the contracts entered into after June 20, 2001, granted rehearing and dismissing complaints related to two qualifying facilities, and denied all other requests for rehearing and clarification.[28] By order dated November 27, 2002,

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[26] April 25 Order, 99 F.E.R.C. at 61,383.

[27] Public Utilities Commission of California v. Sellers of Long Term Contracts, 100 F.E.R.C. ¶ 61,098 at P 12 (2002) (July 23 Order).

[28] July 23 Order, 100 F.E.R.C. ¶ 61,098. The Commission clarified that the complaints against Clearwood; Fresno; Wellhead

the Chief Administrative Law Judge suspended the proceeding as to Williams pending finalization of the parties' settlement agreement. Therefore, Complainants continue to pursue complaints against only seven sellers: Allegheny, Mirant, Coral, El Paso, Dynegy, Morgan Stanley, and Sempra.

15. Additional background on this proceeding is provided in Appendix B.

II. Discussion

A. Procedural Matters

1. Notice of Withdrawal of Complaints as to Williams

16. On January 13, 2003, Complainants filed a joint notice of withdrawal of their complaints with prejudice as to Williams and a joint motion requesting an order to approve such withdrawal. Rule 216 of the Commission's Rules of Practice and Procedure, 18 CFR § 385.216(b)(1) (2003), provides that the withdrawal of any pleading, such as a complaint, is effective at the end of 15 days from the date of filing of a notice of withdrawal, if no motion in opposition to the notice of withdrawal is filed within that period and the decisional authority does not issue an order disallowing the withdrawal within that period. If a motion in opposition to a notice of withdrawal is filed within the 15-day period, the withdrawal is not

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Companies; PPM; and Sunrise were dismissed and that the complaints against Clearwood, Wellhead Companies, PPM and Sunrise were dismissed with prejudice. *Id.* at P 28. The Commission also dismissed the complaints against IVRRC and Soledad. *Id.* at P 19.

effective until the decisional authority issues an order accepting the withdrawal.[29]

17. PG&E filed a timely response to the notice of withdrawal requesting that the Commission clarify: (1) that Williams' settlement with Complainants and any other litigant does not compromise the claims of PG&E and other non-settling parties in Docket No. EL00-95, *et al.*, or elsewhere for energy and related products procured by and paid for by PG&E or that PG&E is found liable to pay for; and (2) that permitting this withdrawal would not constitute a ruling upon, or approval of, any provisions of the Williams' settlement with Complainants.

18. Rule 216 does not require the party seeking withdrawal of a pleading to show good cause; on the contrary, it requires good cause for disallowing the withdrawal. We find no such good cause here. Complainants and Williams have agreed to the withdrawal, and we find no reason to force Complainants and Williams to continue to litigate when they do not wish to do so. Therefore, we grant the withdrawal at issue. We clarify that our action with respect to the withdrawal of the complaints as to Williams will not affect in any way the amount of refunds that Williams may owe in Docket No. EL00-95, *et al.*, or elsewhere. We further clarify that we only address here the withdrawal of the complaints as to Williams and do not rule substantively on the proposed settlement agreement between Complainants and Williams.

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[29] 18 CFR § 385.216(b)(2) (2003).

2. Allegheny Settlement Agreement

19. On June 11, 2003, Complainants, Allegheny and Allegheny Trading Finance Company (collectively, the Settling Parties) filed a settlement agreement (Allegheny Settlement Agreement).[30] The Settling Parties requested that the Commission stay this complaint proceeding against Allegheny pending Commission action on the filing.

20. Without accepting the Settling Parties' characterization of their request as seeking a "stay," we will defer action as to Allegheny at this point pending our review of, and decision on, the proposed settlement.

3. ALJ's Ruling Prohibiting Discovery on Market Power/Market Manipulation

21. Complainants claim that the ALJ erred in prohibiting discovery on market power/market manipulation and in admitting evidence of alleged losses while preventing Complainants from conducting meaningful cross-examination. They assert that they sought this information to counter Respondents' market fundamentals' arguments. Complainants state that, if the Commission concludes that Complainants have sufficiently proven their case without evidence of market abuse, then this issue is moot. Complainants argue that, if the Commission concludes otherwise,

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[30] On that same date, in Docket No. ER01-1847-001, Complainants and Allegheny filed an Amended and Restated Master Power Purchase and Sale Agreement between Allegheny Trading and CDWR (Amended and Restated Agreement).

then the Commission should either: (1) remand for discovery and hearing on the issue of market abuse, or (2) presume that each Respondent (a) committed market abuse in a manner that contributed to the meltdown of the spot market and (b) had a basis for expecting that abuse of that type would enhance future spot market prices, the benefits of which they would not forego by signing forward contracts based upon expectations of lower prices.

22. Sellers argue that the ALJ properly excluded from the proceeding inquiry into market power and costs. Sellers claim that Complainants' argument that they should have been allowed to submit evidence regarding alleged market manipulation constitutes a collateral attack on the April 25 Order in this case, which limited the scope of the proceeding to the exclusion of market power issues and was an improper attempt to seek interlocutory appeal. Sellers dispute Complainants' assertion that they were prejudiced by the inability to present evidence of market power. Sellers further state that, in any case, there is no basis in the record for the presumption that the expectation of the alleged continued existence of market power when market conditions were tight substantially inflated prices in the long-term bilateral markets.

23. Allegheny avers that Complainants' request to conduct discovery on allegations of market power are improper and irrelevant because Complainants have failed to show any connection between the dysfunctional Independent System Operator (ISO) and Power Exchange (PX) markets and the long-term bilateral market.

24. We find that the ALJ properly interpreted the Commission's orders in this proceeding on the exclusion of market power/market manipulation information and properly prohibited discovery on this issue. Therefore, we affirm the ALJ's ruling. We also address the issue of market manipulation in more detail below.

4. ALJ's Ruling Admitting Rebuttal Testimony of Mr. Koenig

25. Complainants claim that the ALJ erred in admitting the Rebuttal Testimony of David Koenig to the extent it purported to quantify Allegheny's losses under its contract with CDWR. Complainants assert that they were prejudiced by the late production of the purported backup data to this testimony. Complainants contest the ALJ's decision to permit Allegheny to submit testimony without backup data, refuse to strike the testimony when Allegheny had not provided any backup data by the date of the hearing and require Complainants to cross-examine Mr. Koenig using backup data that could not be read in the allotted time or used meaningfully in cross-examination. Complainants request that the Commission strike Mr. Koenig's Rebuttal Testimony on costs but allow it to be refiled in the remedy phase of these proceedings after appropriate discovery.

26. Allegheny argues that the ALJ judge properly admitted Mr. Koenig's testimony on Allegheny's up-front losses because the ALJ found that Complainants were not prejudiced in any way.

27. We defer to the ALJ's finding that Complainants were not prejudiced in any way by the admission of Mr. Koenig's Rebuttal Testimony and, therefore, deny Complainants' request to strike. However, our ruling on the merits does not rely on this testimony, as discussed below.

5. Request to Include in Record Market Manipulation/Abuse Evidence Submitted in Docket Nos. EL00-95, *et al.*, and Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse.

28. On April 22, 2003, Complainants filed a Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse. Complainants have submitted a supplemental filing asserting the relevance of certain evidence adduced in Docket No. EL00-95, *et al.*, (100-Day Discovery Proceeding) to this proceeding. Complainants acknowledge that, at the time of their supplemental filing, the record of this proceeding had been closed, post-trial briefing had been completed and the entire record had been certified to the Commission. They state, however, that the Commission's February 10 Order in EL00-95, *et al.*,[31] raised the question of whether the Commission intended to effectively grant Complainants' request for remand for discovery and hearing on the issue of market abuse in this proceeding.

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[31] February 10 Order, 102 F.E.R.C. ¶ 61,164.

29. The Commission did not intend to grant Complainants' request for remand indirectly through the February 10 Order.[32] The additional discovery and adducement of evidence granted in the Commission's November 20, 2002 Order[33] and subsequently clarified in the February 10 Order were limited to Docket No. EL00-95, *et al.*[34] The February 10 Order did direct parties to file an index for each other pending or proposed proceeding for which the filer claims its submission is relevant;[35] however, this directive was not an authorization for further discovery in the instant case or a finding that such information is relevant or admissible herein.

30. Complainants also request that the Commission reopen the record to admit or take official notice of: (1) FERC Staff's Final Report on Price Manipulation in Western Markets, Docket No. PA02-2-000 (March 2003) (Staff Report) and the evidence upon which the Staff Report is based, and (2) the evidence of market manipulation/abuse introduced in Docket Nos. EL01-10, IN01-3, EL02-113-000, EL02-114-000, EL02-115-000, EL02-80, EL02-81, EL02-82 and EL02-83.

31. At Oral Argument, Complainants argued that the evidence of market manipulation is relevant to the application of the "public interest" test. In Complainants' opinion, a contract with a seller who is found by the Commission to have participated in market manipulation should be abrogated because

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[32] *Id.*

[33] November 20 Order, 101 F.E.R.C. ¶ 61,186.

[34] February 10 Order, 102 F.E.R.C. ¶ 61,164.

[35] *Id.* at 61,446.

sellers that abuse market rules and standards of behavior should not be allowed to derive windfall profits from a traumatized market at the expense of customers. Complainants also suggested that a remand to the ALJ may be necessary to adduce additional evidence on market manipulation.

32. Coral responds that market power and manipulation are assumed and are not an issue in this proceeding because when the Commission set these complaints for hearing it assumed that the spot market was dysfunctional. Coral argues that the Staff Report is not evidence upon which the Commission could base its decision because it has not been subject to discovery, cross-examination or rebuttal. Coral asserts that it is pointless to reopen the record to admit the statistical analysis in the Staff Report because, according to Complainants' evidence in this proceeding, the analysis documented in the Staff Report is not sufficiently powerful to detect the linkage, let alone "significant" linkage, between contemporaneous spot and forward prices. Coral contends that, even if the simple regression analysis in the Staff Report were powerful enough to detect the linkage between contemporaneous spot and forward prices, the results show low coefficients which do not establish an adverse effect of sufficient magnitude to warrant contract abrogation. Coral also disputes the interpretation of the slight correlation which is provided in the Staff Report.

33. Sellers argue that Complainants have not demonstrated that extraordinary circumstances exist to reopen the record to bring in "evidence" that is not related to one of the issues at the heart of this proceeding. They note that the Commission did not

require Complainants either to prove that the ISO and PX spot markets were dysfunctional or to demonstrate the causes of that dysfunction, but rather were allowed to presume conclusively that those spot markets were dysfunctional. Sellers contend that it would be inappropriate for the Commission to take official notice pursuant to Rule 508, as requested, because the "evidence" of market manipulation in several other dockets and the Staff Report are contested facts. Sellers assert that, even if the correlation analysis in the Staff Report were allowed into the record, it would not support or compel a conclusion that dysfunctions in ISO spot markets adversely and materially affected forward markets. Sellers argue that Complainants made a tactical decision not to submit a statistical correlation analysis at hearing and must live with the consequences of that decision. They point out that Complainants have not distinguished the correlation analysis in the Staff Report from any other expert evidence that Complainants might have submitted at hearing or shown that it enjoys any special evidentiary status by virtue of having been performed by members of the Commission's Staff that would reward them with the opportunity to revisit their own tactical missteps. Sellers also note that the Staff Report only recommends remand to the presiding ALJ for contracts subject to the "just and reasonable" standard of review. Sellers contend that the "evidence" of market power and manipulation for other proceedings fall outside the scope of issues set for hearing in the April 25 Order and, even if considered, would not add substantive support to Complainants' case.

34. We find that Complainants' request that we take official notice of the Staff Report findings and evidence submitted in the 100-Day Discovery

Proceeding is moot because we have considered these findings and evidence as part of the record of this proceeding. As discussed below, we conclude that, even if we assume that the allegations and findings contained in the Staff Report and the 100-Day Discovery Proceeding were true, they would not be determinative of the issues in this proceeding. We deny Complainants' request to take official notice of or reopen the record to admit evidence submitted in other proceedings. The records of those proceedings contain thousands of submittals, most of which are case-specific and not relevant to the issues in the instant proceeding; the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.

6. Motion to Lodge

35. On January 29, 2003, CDWR filed a complaint against Allegheny Energy Supply Company, L.L.C. (Allegheny Energy Supply) and Allegheny Trading Finance Company (Allegheny Trading) in the Superior Court of California, County of Sacramento. In its complaint, CDWR seeks to terminate its master sales contract and two confirmation letters that were assigned by Allegheny Energy Supply to Allegheny Trading based upon issues allegedly related to the assignment. Complainants request that the Commission consider this complaint within the context of this proceeding.

36. On December 4, 2002, the Commission authorized the assignment as consistent with the public interest and rejected CEOB's arguments against

the assignment.[36] Given the Commission's approval of the assignment and prior decision not to stay the approval of the assignment pending the resolution of the issues in this proceeding, we deny Complainants' motion to lodge this complaint in this proceeding.

B. Commission Determination Regarding Substantive Issues Findings of Fact and Conclusions of Law

37. In deciding whether the Complainants have met their burden of proof under the "public interest" standard of review to justify contract modification in these cases, we rely on the evidentiary record developed in this proceeding and also consider the findings of the Staff Report and evidence submitted in the 100-Day Discovery Proceeding. The Staff Report found that spot market distortions flowed through to forward power prices, particularly those for contracts of a short-term nature, *i.e.*, one to two years time to delivery. In addition, the Staff Report and the 100-Day Discovery Proceeding suggest that the California ISO and PX markets were subjected to market manipulation and gaming. The Staff Report conclusions and the 100-Day Discovery Proceeding documents are being contested in "show cause" proceedings involving allegations and/or findings of manipulation in the spot markets. However, even if we were to assume that these allegations and/or findings were true, they would not be determinative of the issues in the instant proceeding. The Commission has already concluded that the California ISO and PX spot

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[36] Allegheny Energy Supply Company, *et al.*, 101 F.E.R.C. ¶ 61,278 (2002).

markets were dysfunctional during the relevant period and that rates in those markets were unjust and unreasonable.[37] Evidence of market manipulation merely suggests yet another cause of the spot market dysfunctions and the unjust and unreasonable rates in the spot markets. However, a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a "just and reasonable" standard of review.[38] As we have concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the "public interest" standard of review. Under the "public interest" standard, to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary to the public interest.[39] As fully discussed below, we conclude that the Complainants failed to make such a showing.

38. As determined by the Presiding ALJ and affirmed in this order, Complainants in this

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[37] *See, e.g.*, San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, 93 F.E.R.C. ¶ 61,121 at 61,359-60 and 61,372 (2000) (November 1 Order); *order on reh'g and clarification*, 97 F.E.R.C. ¶ 61,275, at 62,225 (2001).

[38] This conclusion is consistent with the Staff Report recommendation that, only for contracts subject to the "just and reasonable" standard of review, the Commission should send the Staff Report findings on the influence of the spot prices on forward prices to the ALJs to use as they see fit to resolve complaints. *See* Staff Report at V-19.

[39] *See, e.g.*, *Sierra*, 350 U.S. at 354-355.

proceeding must meet the "public interest" standard in order to justify the requested contract modification. The ALJ concluded that Complainants failed to meet their burden of demonstrating that the contracting parties intended another standard of review to apply.[40]

39. The parties have failed to distinguish evidence required to demonstrate that a contract is not just and reasonable and that needed to demonstrate that the *Mobile-Sierra* "public interest" test has been met. The parties spent most of the trial and their briefs attempting to demonstrate whether the contract rates were just and reasonable. A summary of the parties' arguments and rebuttals are provided in Appendix C. The arguments which are relevant have been addressed herein. They presented very little evidence relevant to the *Mobile-Sierra* standard of review. Based on the record, we conclude that Complainants have failed to demonstrate that any of the three prongs announced in the *Sierra* case has been met or that any other factor introduced into evidence warrants a finding that any of the contracts is contrary to the public interest and should be modified.

40. Based on the record, we conclude that there is no credible record evidence that the contracts at issue are placing Complainants in financial distress or that other customers will bear an excessive burden as a result of upholding the challenged contracts. In fact, one of CDWR's central objectives was to achieve a portfolio that yielded a weighted average price no higher than $70/MWh, the average cost of energy supply reflected in the IOUs' retail rates, as of

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[40] *See* Partial Initial Decision, 102 F.E.R.C. at P 43 and 45.

January 2001.[41] In securing its contracts, CDWR achieved an overall portfolio that is diversified both in terms of energy products and durations[42] and reflects an average price of $70/Mwh.[43] The average price for the first 5 years (May 2001 to December 2005) was estimated at $84/Mwh and for the last 5 years (January 2006 to December 2010) was estimated at $60/Mwh.[44] Complainants were unable to demonstrate that the contracts were priced above long-run competitive prices.[45]

41. Furthermore, Complainants have failed to present evidence showing that the challenged contracts are unduly discriminatory. In the past, the *Mobile-Sierra* doctrine has been applied to allegations of discriminatory or preferential treatment to the detriment of other purchasers who are not parties to the contract.[46] No such showing has been made by Complainants.

42. In addition to the evidence on the effects of the challenged contracts on the parties and customers, the

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[41] Exh. CAL-51 at 10:24-11:3; Exh. AYE/SER-7 at 70:22-71:4 (Hart- deposition); Exh. AYE/SER-11 at 64:11-66:2 (Nichols deposition); Tr. at 1258:14-1260:9; Exh. S-8 at 16:2-23.

[42] Exh. DYN-38 at 1.

[43] Exh. CAL-70 at 13 of Update of California Department of Water Resources Power Purchase Contract Efforts dated May 31, 2001 (May 31, 2001 CDWR Update); Exh. CAL-51 at 31:16-19; Exh. DYN-1 at 16:25-27.

[44] Exh. CAL-70 at 13 of May 31, 2001 CDWR Update.

[45] Exh. MAEM-25 at 6:20-9:22; Exh. COR-48; Exh. COR-50; Exh. CAL-163 at 1:22-2:7.

[46] *See* Papago Tribal Authority v. F.E.R.C., 723 F.2d 950, 953 n.4 (D.C. Cir. 1983) (Papago).

ALJ has developed an extensive evidentiary record on the totality of circumstances preceding and following the execution of the contracts at issue.

43. Specifically, the record shows that CDWR had options and at least some bargaining power when it entered into this portfolio of contracts after often protracted negotiations. During late January and early February 2001, Governor Davis signed legislation that authorized CDWR to purchase, mostly through long-term contracts, the "net-short" requirement of California's IOUs, approximating 10,000 MW.[47] The "net short" requirement is the difference between the amount of power that could be supplied by the California IOUs from their resources and the total demand for power at any given time.[48] Originally, to cover the net short positions, CDWR obtained almost all of the power it needed from either the spot market or "out of market."[49]

44. On January 22, 2001, Governor Davis' office announced that CDWR would issue a Request for Bids for Energy Purchase (RFB) and explained that the Governor "expect[s] these bids on long term energy contracts should stabilize the market and drive the price of electricity down . . . . This is a key step in our efforts [to] keep the lights on in California at a reasonable price."[50]

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[47] Exh. COR-1 at 8:1-7; Exh. COR-25 at 16:22-24; Exh. CAL-13; Exh. EPME-1 at 30:7-11; Exh. CAL-15.

[48] Exh. CAL-78 at 6:9-12; Exh. DYN-1 at 8:10-12.

[49] Exh. S-4 at 16:19-17:1.

[50] Exh. COR-1 at 8:7-13; Exh. COR-6; *accord* Exh. DYN-12 at 50:3-16.

45. On January 23, 2001, CDWR issued its first RFB.[51] CDWR sought bids at fixed prices for 69,000 to 100,000 GWH of on-peak energy annually and another 26,000 to 40,000 GWH of off-peak energy annually.[52] CDWR received 99 bids in response.[53]

46. CDWR assembled a highly sophisticated procurement team to assist in CDWR's purchasing efforts.[54]

47. On February 1, 2001, the California Legislature passed Assembly Bill 1 of the 2001-2002 First Extraordinary Session ("AB1X"), which authorized CDWR "to enter into contracts for the purchase of electric power."[55] AB1X authorized, but did not require, CDWR to make power purchases to cover the California IOUs' net short position.[56] Under AB1X, CDWR could enter into long-term power purchase contracts but could not provide any sovereign guaranty

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[51] Exh. CAL-66; Exh. COR-25 at 9:21-22; Exh. EPME-28 at 2:11-12, 3:15-16.

[52] Exh. CAL-66; Exh. S-4 at 18:14-16.

[53] Exh. AYE-57.

[54] Exh. AYE-56 at 1; Exh. AYE-49 at 11:2-10; Exh. COR-1 at 10:16-11:20; Exh. COR-8; Exh. CAL-78 at 1:7-2:18; Exh. CAL-79; Exh. CAL-12 at 3:18-21; Exh. CAL-51 at 4:5-5:14, 1:3-19, 5:15-7:3; Exh. DYN-41 at 8:4-19; Exh. COR-67 at 222:22-223:6; Tr. at 1588:10-12, 1589:23-24, 1590:18-20; Exh. S-4 at 16:5-9; Exh. COR-41 at 5:12-6:7, 12:8-15; Exh. MAEM-1 at 16:4-8; Exh. EPME-56 at 4:18-5:1; Exh. EPME-28 at 5:7-9; Exh. EPME-35 at 1; Exh. COR-67 at 49:7-50:9; Exh. DYN-48 at 39:7-40:7; Exh. DYN-40 at 8:1-12; Exh. DYN-45 at 20:12-18, 21:13-22:6; accord, Exh. DYN-53 at 17:17-21.

[55] Exh. CAL-15; *accord*, Exh. S-4 at 15:21-16:2.

[56] Exh. CAL-15; Exh. DYN-1 at 9:11-16.

(*i.e.*, its obligations were expressly not backed by the full faith and credit or taxing power of the State of California).[57]

48. On February 2, 2001, CDWR issued a second RFB requesting a mix of products and indicating that it was willing to buy from supply portfolios.[58] Like CDWR's first RFB, this RFB also emphasized that bidders, and not CDWR, would be responsible for ensuring delivery to the specific congestion zone and that CDWR would assume neither transmission nor congestion risk and continued to require fixed pricing only.[59] The RFB did not indicate a preference for 1 to 3-year contracts or any other specific duration.[60] CDWR's RFB solicited opportunities for different products to be offered up by prospective bidders.[61] CDWR received 114 bids in response.[62]

49. CDWR received a total of 213 offers to its first and second RFBs.[63] Within a few weeks, CDWR was able to assemble a portfolio of approximately 41 commitments, totaling approximately $43 billion.[64]

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[57] Exh. CAL-15; Exh. CAL-66; Exh. CAL-67; Exh. EPME-56 at 3:14-15.

[58] Exh. CAL-67; Exh. S-4 at 18:18-19:3; Exh. COR-1 at 8:20-10:5; Exh. EPME-28 at 4:16.

[59] Exh. CAL-67; Exh. COR-1 at 8:20-10:5; Exh. EPME-28 at 4:17-18.

[60] Exh. CAL-67; Exh. S-4 at 18:18-19:2; Exh. COR-1 at 8:20-10:5; Exh. COR-41 at 20:13-21:2.

[61] Tr. at 1253:10-11.

[62] Exh. AYE-58; Exh. CAL-67.

[63] Exh. AYE-57; Exh. AYE-58; Exh. DYN-40 at 6:17-18.

[64] Exh. S-4 at 19:18-19.

This portfolio covered about 12,000 MW during the peak year.[65] In addition to the responses to the RFBs, CDWR negotiated with suppliers outside the RFB process.[66] There was competition among sellers to make offers to CDWR and, as a result, CDWR had choices and rejected numerous seller proposals.[67]

50. CDWR negotiated with the sellers on an individual basis and controlled what information they had regarding the success of CDWR's procurement strategies.[68] CDWR gained negotiating leverage with each agreement that it reached with the sellers.[69] Contemporaneous statements made by CDWR and the Governor of California indicate that they fully supported the price, terms and conditions in the contracts at the time they were executed.[70] On May 24, 2001, counsel and a negotiator for CDWR, prepared a memorandum to a CDWR representative, at the latter's request, in which he stated that "[e]ach power purchase agreement was the subject of often protracted negotiations. Frequently, sellers had to concede numerous points to obtain the terms and

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[65] Exh. S-4 at 19:19-20.

[66] Tr. at 1563:2-4; Tr. at 1564:16-25.

[67] Exh. AYE-80 at 196:15-25; Exh. AYE-61; Exh. EPME-28 at 11:1-3; Exh. COR-48 at 15:4-9.

[68] Exh. COR-63 at 2; Exh. AYE-51; Tr. 1561:14-1562:9; Exh. AYE/SER-1 at 37:18-21.

[69] Exh. AYE-80 at 271:23-272:8; Exh. J-2 at 170:14-21; Exh. COR-48 at 15:4-7; Exh. AYE-52.

[70] Exh. DYN-37 at 1; Exh. COR-61 at 1; Tr. at 1496:7-15; Exh. COR-62; Exh. DYN-38; Exh. DYN-26 at 152:16-153:8; Exh. DYN-27 at 210:24-211:19; 215:15-217:2; 221:23-222:12.

provisions they ultimately ended up with in the agreements."[71] CDWR's lead negotiator stated that

> I can't get terribly upset by these critics who say oh, by gosh, this is higher than what the price might be. Well, hell, they don't know. We didn't just fall off a turnip truck. I am not saying we took the shirt off their back. But I am saying that these were fair, negotiated, hard-fought deals.[72]

51. The rates, terms and conditions of the contracts and concessions made by the various parties during negotiations indicate that the contracts were not the product of unequal bargaining power.[73]

52. CDWR had options and did not lack bargaining power, given the number of parties who were interested in selling power to the State of California on a long-term basis.[74] CDWR was "essentially a single purchaser," and CDWR knew its actions would affect market prices.[75]

53. Although CDWR was viewed as more creditworthy than the California IOUs, its

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[71] Exh. AYE-51 at NAV08-016238; Tr. at 1561:14-1562:18.

[72] Exh. DYN-26 at 152:16-153:8.

[73] Exh. DYN-1 at 41:4-15; Exh. DYN-1 at 19:9-14, 22:21-23:11; Exh. EPME-28 at 4:4-5, 8:7-9:13; Exh. SER-1 at 3:25-5:6.

[74] Exh. COR-7 at 1; Exh. AYE-57; Exh. AYE-58; Exh. AYE-49 at 8:8-9; Exh. CAL-90 at 3:21-4:1; Exh. AYE-80 at 271:23-272:8;Exh. CAL-51 at 36:12-16; Exh. J-2 at 170:14-21; Exh. MAEM-1 at 17:1-3.

[75] Exh. CAL-90 at 3:21-4:1; Tr. at 1856:21-1857:16.

creditworthiness was still a concern to the marketplace.[76] Thus, the distribution of risks in CDWR's contracts was not symmetric between CDWR and the sellers under many contracts.[77] CDWR was, however, in a favorable bargaining position as a buyer of forward bilateral contracts because it was the largest, creditworthy bulk buyer in the State of California.[78] This fact gave CDWR a great deal of bargaining power over sellers of long-term contracts.[79] Negotiators on behalf of CDWR pressured sellers into doing deals with the State by indicating that "the Governor's office would use the media against companies that failed to deal with California."[80]

54. CDWR was able to demand and obtain many concessions from the Sellers, including obligating many, if not all, of the sellers to: (1) make immediate and/or near-term sales to CDWR at below-market prices, (2) assume transmission and congestion risk and provide high supply availability guarantees, (3) allow CDWR to dispatch the supplier's generation, (4) assume the risk of changes in fuel prices, and (5) provide CDWR the option of choosing seller-supply

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[76] Exh. EPME-1 at 53:5-54:2.

[77] *Id.*

[78] Exh. DYN-24 at 20:6-14; Exh. MAEM-1 at 15:26-16:4; Tr. at 2389:21-2390:4; Exh. SER-1 at 28:9-11.

[79] Exh. DYN-40 at 5:18-20; Exh. MAEM-1 at 16:14-17:3; Exh. AYE/SER-1 at 37:17-38:3.

[80] Exh. DYN-1 at 23:4-5; *accord*, Exh. MAEM-1 at 16:19-23, 16:25-17:3.

and/or CDWR-supply of natural gas.[81] In certain of the contracts under review, even though the sellers proposed a fuel price indexing formula, CDWR insisted on a fixed price, thereby leaving sellers to bear the risk that fuel prices would increase in the future.[82]

55. CDWR rejected a number of contract offers for many reasons, including pricing, transmission constraints, credit issues and terms (*e.g.*, length of contract, type of product).[83] CDWR rejected contracts with a large number of suppliers offering, in the aggregate, more than 10,000 megawatts for sale to CDWR.[84] There was give and take involved in the negotiations: CDWR would sometimes reject certain proposals and sellers would come back to CDWR with new proposals.[85]

56. CDWR articulated the State's purchasing objectives in a report titled "Summary of California Department of Water Resources Power Purchase Contract Efforts."[86] Its objectives included: (1) creating a power purchase portfolio to reduce dependence on the spot market, (2) providing price stability and certainty, and (3) expediting construction

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[81] Exh. COR-1 at 46:3-47:5; Exh. AYE-14 at 3:1-4:20; Exh. EPME-28 at 10:4-14; Exh. MAEM-1 at 13:5-18; Exh. MSC-1 at 6:16-7:2; Exh. SER-1 at 25:8-26:21; Exh. DYN-1 at 26:15-27:3.

[82] Exh. S-1 at 25:8-11.

[83] Exh. AYE-61 at DW-0015-0794; *accord*, Exh. AYE-80 at 227:12-14; Exh. AYE-59 at 90:11-13, 93:6-20; Exh. EPME-1 at 63:8-14; Exh. EPME-47 at 36:10-11.

[84] Exh. AYE-1 at 4:14-16.

[85] Exh. AYE-80 at 227:12-20.

[86] Exh. CAL-70.

of new power plants, peaking facilities and distributed generation.[87] CDWR also sought to secure delivery of power in calendar year 2001.[88]

57. CDWR took a deliberate and systematic approach to building its portfolio of power supply resources needed to cover the net-short requirements of the IOUs.[89] It began by negotiating commitments to buy around-the-clock power (7x24) and then began to shift its focus toward meeting on-peak requirements, which was followed with an effort to secure supply reductions in shoulder months.[90] Initially, CDWR wanted as much firm power under contract as it could obtain as soon as possible so it could immediately publicize these lower prices and reduce price volatility.[91] CDWR was looking for baseload, dispatchable, peaking, unit firm, and unit contingent products.[92] CDWR sought to obtain a portfolio of contracts, some with fixed prices and some with tolling provisions so that it could hedge its risk.[93]

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[87] Exh. CAL-70 at 1; *see also* Exh. COR-67 at 141:14-142:2.

[88] Exh. CAL-51 at 29:3-30:6.

[89] Exh. COR-1 at 44:19-45:13; *accord*, Exh. MAEM-1 at 15:23-26.

[90] Exh. COR-1 at 44:19-45:13; Exh. COR-41 at 13:19-14:1.

[91] Exh. DYN-1 at 17:19-22.

[92] Tr. at 1559:23-1560:7; accord, Exh. COR-67 at 94:7-95:20; Exh. EPME-28 at 3:16-20.

[93] Exh. AYE-80 at 132:13-133:5.

58. CDWR sought products of 90 days, three years, five years, and 10 years in duration.[94] CDWR sought contracts for a 10-year period because California "needed new energy in addition to getting existing energy in the [S]tate under contract," and CDWR "recognize[d] that financing of new plants would require a longer period of time from which to get a reasonable price. [CDWR] did not want to be paying for a new plant in two, [or] three years. [CDWR] expected to see some contracts come in a 10-year period for that reason."[95] Most of the contracts entered into by CDWR to remedy its dependence on the spot market were for terms of ten years or more.[96] CDWR understood that long-term contracts were "one building block . . . in solving the energy crisis."[97]

59. CDWR expected that supplies during summer 2001 could be scarce and, therefore, placed greater value on supply certainty, and sellers were offered incentives to bring supplies to the market.[98] CDWR was able to reduce its exposure to the spot market, stabilize prices and obtain a certainty of supply and portfolio of contracts.[99]

60. Based on the above, we conclude that Complainants have failed to demonstrate the financial

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[94] Tr. at 1559:18-22; *accord*, Exh. CAL-78 at 8:12-18; Exh. EPME-28 at 3:18-19; Exh. S-4 at 18:16-19:2; Exh. CAL-66; Exh. CAL-67.

[95] Tr. at 1719:2-13.

[96] Exh. COR-25 at 4:1-6.

[97] Exh. DYN-12 at 49:17-23.

[98] Exh. EPME-47 at 26:15-27:19.

[99] Exh. CAL-78 at 5:6-13, 17:9-15.

impairment, excessive burden or undue discrimination described in *Sierra* or any other factor sufficient to meet the "public interest" standard of review. Moreover, the contracts at issue were the result of choices voluntarily made by CDWR. The record also establishes that CDWR had better alternatives[100] and was not compelled to enter into the contracts at issue here.

61. Finally, there is nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contract negotiations resulting in prices and terms being challenged here.

62. Therefore, based on the record, it appears that Complainants' only basis for contract modification is their dissatisfaction with the bargain. Commission and court precedent clearly establish that allegations that contracts have become uneconomic by the passage of time do not render them contrary to the public interest under the FPA.[101] The record clearly indicates that the challenged transactions were the result of CDWR's voluntary choices. Therefore, because there is no evidence of unfairness, bad faith, or duress in the original negotiations, Complainants are not entitled to change CDWR's bargains.[102]

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[100] *See* Exh. AYE-57 and Exh. AYE-58.

[101] *See PEPCO*, 210 F.3d at 409 (*citing Soyland*, 51 F.E.R.C. at 61,013). *See also Papago*, 723 F.2d at 953; *Sierra*, 350 U.S. at 354-355.

[102] *See PEPCO*, 210 F.3d at 410.

63. For these reasons, we find that Complainants have failed to meet their burden of proof under the "public interest" standard and contract modification in this case is thus not warranted.

C. Partial Initial Decision

64. The ALJ concluded that the case law is clear that where a contract fails to specifically provide that the contract may be unilaterally altered, *Mobile-Sierra* requires that proposed changes meet the "public interest" standard.[103] Under the *Mobile-Sierra* doctrine, the U.S. Supreme Court had held that a contract with a "public interest" standard of review may be modified only if the contract is shown to be contrary to the public interest (*e.g.*, where the contract rate impairs the financial ability of the public utility to continue service, casts upon other customers an excessive burden, or is unduly discriminatory).[104] The ALJ noted that while the *Mobile-Sierra* doctrine arose in the context of a completely regulated environment, where, as here, the contracts were entered into under the parties' market-based rate authority, the Commission has stated that "[p]reservation of the contracts has, if anything, become even more critical."[105]

65. The ALJ reviewed the evidence in the record proffered by the contracting parties regarding the intent of the parties as to unilateral filing rights under the subject contracts aside from the express language

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[103] Partial Initial Decision, 102 F.E.R.C. at P 28.

[104] *Sierra*, 350 U.S. at 355.

[105] Partial Initial Decision, 102 F.E.R.C. at P 31 (quoting April 25 Order, 99 F.E.R.C. at 61,383).

of the contracts themselves.[106] The ALJ found that the "evidence demonstrates that the contracting parties did not intend to preserve their rights to make unilateral application to the Commission for changes in rates, terms or conditions" of the Dynegy, El Paso, Morgan Stanley or Sempra contracts.[107] Rather, the ALJ found that "the extrinsic evidence of record indicates that the State had very little confidence in the Commission as an avenue for relief at the time these contracts were negotiated, that CDWR negotiated the subject contracts in a 'crisis' environment, and that for various reasons CDWR's negotiating team focused almost exclusively on the pricing terms of the subject contracts."[108] The ALJ notes that, in fact, Sempra's witness testified that precluding unilateral application to the Commission for changes in rates, terms and conditions was an issue of importance to CDWR and that the parties agreed to language precluding the Commission from changing

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[106] *See* Partial Initial Decision, 102 F.E.R.C. at P 36-42. The evidence of the contracting parties' intent on this issue is as follows: Exh. SER-1 at 34:6-36:14 (Niggli); SER-2; Exh. SER-32 at 6:17-7:5 (Niggli); Exh. SER-34; Exh. SER-35; Exh. SER-55; Exh. SER-56; Exh. DYN-1 at 12:10-12, 26:15-18, 31:23-32:24, 33:6-9, 33:10-34:5 (Lednicky); Exh. DYN-2 at EOB-DYN-1-0005286; Exh. DYN-40 at 16:3-6 (Lednicky); Exh. MSC-1 at 9:12-18 (Hamdan); Exh. S-1 at 6:15-8:17, 11:1-11, 15:10-19:2 (Forman); Exh. S-4 at 6:11-15:14 (Tingle-Stewart); Exh. CAL-181 at 308:12-25 (Freeman); Tr. at 1633:8-1637:6 (Hart); Tr. at 2292:16-2293:6 (Smith); Tr. at 2476:5-2482:6 (Forman); Tr. at 2486:8-21 (Forman); Exh. US-1 at 13:3-14:16 (Thomas); Tr. at 2143:13-2149:11 (Lednicky); Tr. at 2293:8-15 (Smith); Tr. at 2458:4-7 (Forman). *See id.* at P 35-42.

[107] *Id.* at P 43 (*citing see, e.g.*, Exh. SER-1 at 34:10-26 (Niggli); Exh. DYN-1 at 33:10-34:5 (Lednicky)).

[108] *Id.* at P 43.

the contract rates, terms and conditions.[109] The ALJ concluded that "[a] review of each of the four remaining contracts and of the evidentiary record in this proceeding supports a finding that the parties did not retain the right to unilaterally seek changes to their contracts, nor did the parties intend to do so."[110]

66. The ALJ also noted that, on January 14, 2003, after the close of the evidentiary record in this proceeding, after the filing of Initial Briefs, and after issuance of the Commission's January 10, 2003 Order,[111] Complainants "acknowledged that '[they] have not argued, or submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provision in the remaining four contracts is itself a basis for not applying the *Mobile-Sierra* standard to those contracts. Accordingly, to the extent the *Mobile-Sierra* standard applies to the contracts with explicit *Mobile-Sierra* provisions, it applies to the contracts without such provisions.'"[112] The ALJ concluded that:

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[109] *Id.* (*citing* Exh. SER-1 at 34:6-26 (Niggli); Exh. SER-32 at 6:17-28 (Niggli)). For example, the ALJ found that, "with regard to the [Sempra] Agreement, [the President of Sempra] testified that, at CDWR's insistence, language was inserted into the [Sempra] Agreement to ensure that the Commission would not have the ability to review the rates, terms and conditions of the [Sempra] Agreement." Partial Initial Decision, 102 F.E.R.C. at n.22 (*citing* Exh. SER-1 at 34:10-26 (Niggli)).

[110] *Id.* at P 45.

[111] Public Utilities Commission of California v. Sellers of Long Term Contracts, 102 F.E.R.C. ¶ 61,025 (2003) (January 10 Order).

[112] *Id.* at P 44 (*citing* Answer of the California Public Utilities Commission and California Electricity Oversight Board to Motion

while the Complainants maintain their objection to the Commission's rulings on the applicability of the *Mobile-Sierra* standard to *any* of the contracts at issue, Complainants concede that there is no basis in the record, under the Commission's rulings to date in these proceedings, for not applying the *Mobile-Sierra* standard to the Dynegy, El Paso, Morgan Stanley and Sempra contracts[, contracts at issue which did not contain explicit *Mobile-Sierra* language,] to the same extent it applies to the other contracts [with explicit Mobile-Sierra provisions] already before the Commission for determination.[113]

D. Exceptions to Partial Initial Decision

1. Evidence of Market Manipulation and the Exercise of Market Power

a. Argument

67. Complainants argue that the ALJ erroneously concluded that the Commission limited the scope of the evidentiary hearing to matters other than market

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to Hold Briefing in Abeyance, Jan. 14, 2003 (January 14 Answer)).

[113] Partial Initial Decision, 102 F.E.R.C. at P 52. *See also* January 14 Answer at P 7. However, as noted below, Complainants argue that here the "just and reasonable" standard and the *Mobile-Sierra* "public interest" standard effectively merge because it is contrary to the public interest to charge unlawful rates to the public.

manipulation and the exercise of market power. They state that the Commission correctly ruled that proof of the exercise of market power would not be required for Complainants to prevail; however, they contend that the Commission never ruled that such proof should not be allowed. Complainants contend that it would not have been appropriate for the Commission to restrict Complainants' Section 206 rights by prohibiting discovery and precluding evidence of sellers' exercise of market power. They assert that such proof would (1) provide direct evidence that sellers who were actively inflating spot market prices would expect to continue to do so and thus inflate forward prices, (2) rebut Respondents' argument that economic fundamentals alone explain the spot prices and forward prices during the California crisis, and (3) undercut Respondents' argument that the "sanctity" of contracts should be upheld.

68. Complainants argue that Reliant's alleged misconduct[114] stipulated to in Docket No. PA02-2-001 offers direct proof on the central issue that was set for hearing in this proceeding: the dysfunctional exercise of market power in the California PX spot market adversely affecting the long-term bilateral market by artificially inflating forward prices. They contend that such evidence disproves Respondents' experts' claims that market fundamentals during May-June 2000 explain the price inflations that began in May-June 2000 and persisted through June 2001. They conclude

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[114] Complainants refer to Reliant's alleged withholding of approximately 2,000 MW of capacity from the market and falsely reporting to brokers that it needed to buy electricity for the third quarter of 2000 because it foresaw insufficient capacity in its own generation due to emissions (NOx) constraints and/or other capacity factor limitations.

that excluding such direct proof on the threshold issue was erroneous.

b. Responses

69. Trial Staff argues that this exception is merely an attempt to bolster Complainant's contention that the ALJ should have allowed discovery and presentation of evidence of market power and market manipulation at the hearing. It contends that the exception is misplaced since it is not pertinent to the subject matter of the Partial Initial Decision and Complainants have properly briefed this issue directly to the Commission in the second portion of this proceeding. Trial Staff states that Complainants have improperly presented evidence on the merits of an issue ruled outside the scope of the hearing and that the Commission should not countenance Complainant's reliance on extra-record evidence through their citation to the Reliant trader transcripts.

70. Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley and Sempra (collectively, Sellers)[115] argue that the Partial Initial Decision did not open the door for Complainants to restate objections to prior rulings or to submit irrelevant and prejudicial evidence into the record that closed on December 12, 2002. Sellers note that this issue is not a legitimate exception because it falls outside the scope of issues to be addressed by the ALJ as set forth not only in the Commission's April 25, 2002 order but also the January 10, 2003 order. Sellers request that the

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[115] Allegheny, Coral and Mirant joined in Sellers' Brief Opposing Exceptions for the purpose of responding to assertions concerning the content and/or applicability of the *Mobile-Sierra* standard of review, market power and market manipulation.

challenge to rulings on the scope of the hearing in any of Complainants' briefs be rejected as an impermissible collateral attack on the Commission's April 25, 2002 order which limited the scope of the evidentiary hearing to matters other than market manipulation and the exercise of market power. They argue that objections to the limitation on the scope of the hearing should have been sought through rehearing of the April 25, 2002 order. Sellers also contend that Complainants' challenge to the prior rulings of the Chief Judge and ALJ regarding the scope of the proceeding is an untimely, improper attempt to seek interlocutory appeal of such rulings.[116]

c. Commission Determination

71. This exception is not pertinent to the subject matter of the Partial Initial Decision which only addressed the applicable standard of review. However, our consideration of market manipulation and market power evidence is discussed above. Therefore, we dismiss this exception.

2. Application of *Mobile-Sierra* to Buyers and Sellers

a. Argument

72. Complainants reassert their contention that *Mobile-Sierra* should not apply to any of the contracts at issue because Complainants were not the

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[116] *Citing* Pacific Gas Transmission Company, 56 F.E.R.C. ¶ 61,430 at 62,537 (1991); McDowell County Consumers Council, Inc. v. American Elec. Power Company, 26 F.E.R.C. ¶ 61,042 at 61,140 (1984).

contracting parties. However, even if Complainants were actual parties to the contracts, they argue that different factors apply when the *Mobile-Sierra* "public interest" test is applied to a buyer, rather than a seller. They contend that, when it is alleged that rates are too high and the buyer has agreed to pay too much, the "public interest" inquiry asks whether the buyer's customers will bear the burden. They conclude that in a case such as this one, where the rates are directly borne by the public because the buyer was a state agency purchasing power solely for the benefit of the public, the "just and reasonable" standard and the *Mobile-Sierra* "public interest" standard effectively merge because it is contrary to the public interest to charge unlawful rates to the public.

b. Response

73. Trial Staff and Sellers state that Complainants do not take issue with the application of the "public interest" standard to the contracts at issue, but rather with the test to be applied when dealing with a buyer, not a seller, under the *Mobile-Sierra* doctrine. They also note that the ALJ properly cited to *San Diego Gas & Electric Company v. Public Service Company of New Mexico*[117] for the holding that a buyer is subject to the "public interest" standard, notwithstanding that the contract was silent as to the buyer's Section 206 rights. Sellers also cite to other cases in which the "public interest" standard was applied to buyers without collapsing that standard into a lower "just and

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[117] San Diego Gas & Electric Company v. PSC of New Mexico, 91 F.E.R.C. ¶ 61,233 at 61,852-53 (2000) (June 1 Order).

reasonable" analysis,[118] emphasizing two cases in which a buyer's request to modify a contract was rejected.[119]

74. Sellers argue that Complainants' conclusion that they should be subject to a less strict standard of review does not comport with judicial precedent which dictates that the strict "public interest" standard of review applies.[120] Sellers also respond that Complainants' allegation that the "public interest" standard does not consider the effect on ratepayers is unsupportable since this effect is considered in the first and second prong of the test.

c. Commission Determination

75. Complainants appear to argue that, because they are not parties to the contracts at issue and they filed these complaints on behalf of California

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[118] San Diego, 904 F.2d at 730-32; April 25 Order, 99 F.E.R.C. at 61,383, App. A; July 23 Order, 100 F.E.R.C. at 61,394; Public Utilities Commission of California v. Sellers of Long Term Contracts, 101 F.E.R.C. ¶ 61,293 at 62,175 (2002) (December 17 Order); Nevada Power Co., *et al.* v. Enron Power Marketing, Inc., *et al.*, 101 F.E.R.C. ¶ 63,031, 65,277 (2002); *PEPCO*, 210 F.3d at 412.

[119] *San Diego*, 904 F.2d at 730-32; *PEPCO*, 210 F.3d at 412.

[120] Sellers note that there have been cases in which the Commission has applied a more flexible public interest standard; however, those circumstances involved cases in which the Commission had never had an opportunity to review the disputed contracts and the Commission sought to apply a more flexible public interest standard to protect non-parties. *See* Northeast Utilities Serv. Co., 66 F.E.R.C. ¶ 61,332 (1994) (*Northeast Utilities*); Florida Power & Light Co., 67 F.E.R.C. ¶ 61,141 (1994) (FP&L).

customers, the Commission should apply the more flexible "public interest" standard developed in the *Northeast Utilities*[121] line of cases.

76. In the April 25 Order[122] and the July 23 Order,[123] the Commission rejected this assertion that a lower "public interest" standard applies. In those orders, the Commission stated that the State of California entered into the contracts at issue through one of its many agents, CDWR.[124] The Commission does not believe that a different standard of review should apply because these contracts are being challenged by other agents of the State of California, namely CEOB and CPUC.[125] The Commission stated that, in performance of its duty of administering the FPA, it views the State of California, CDWR, CPUC, and CEOB as one and the same entity that, in this case, acted as a buyer in the energy markets.[126] Accordingly, we deny this exception.

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[121] *Northeast Utilities*, 66 F.E.R.C. ¶ 61,332.

[122] April 25 Order, 99 F.E.R.C. at 61,382-383.

[123] July 23 Order, 100 F.E.R.C. at 61,396.

[124] April 25 Order, 99 F.E.R.C. at 61,382-383; July 23 Order, 100 F.E.R.C. at 61,396.

[125] *Id.*

[126] July 23 Order, 100 F.E.R.C. at 61,396.

3. Countervailing Policy Goals and Appropriateness of Modification

a. Argument

77. Complainants assert that the Partial Initial Decision ignores an overriding policy: the public's interest in just and reasonable rates. They also contend that the *Mobile-Sierra* principles would not be compromised if the instant contracts are modified because (1) the contracts were signed during an extraordinary market meltdown, (2) the contracts were signed after the Commission gave notice in its December 15 Order that it was concerned about forward prices and would entertain after-the-fact challenges, and (3) the requested remedy would allow every seller to recover all its legitimate costs, plus a reasonable rate of return. They conclude that the remedy requested in these extraordinary circumstances would not create precedent that would impede contract formation in the normal course.

b. Response

78. Trial Staff notes that the ALJ did not determine whether the contracts should be modified. It states that the ALJ merely noted that, if the parties have not preserved their rights to seek unilateral modifications, then the *Mobile-Sierra* standard of review serves to protect the expectations of the contracting parties that their negotiated agreement will not be modified unless in the public interest.

79. Sellers argue that Complainants' criticism of the policy considerations cited by the ALJ are unjustified

because they flow directly from judicial and Commission precedent.[127]

c. Commission Determination

80. The policy considerations raised here by Complainants were beyond the scope of the Partial Initial Decision. The ALJ was not directed by the Commission to address whether specific contracts should be modified and therefore did not do so. We addressed these policy considerations above, however.

4. Application of the *Mobile-Sierra* Standard to Market-Based Rate Contracts

a. Initial Contract Review Under "Just and Reasonable" Standard

i. Argument

81. Snohomish argues that, because in the market-based rate context there is no initial review and approval of contract provisions such as price and term, the protections guaranteed by the FPA which ensure that all rates, terms and conditions of service are just and reasonable[128] are circumvented if the "public

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[127] *Citing* Partial Initial Decision at P 45 n.25 (*citing* Texaco Inc. v. F.E.R.C., 148 F.3d 1091, 1095 (D.C. Cir. 1998) (*Texaco*); Town of Norwood v. F.E.R.C., 202 F.3d 392, 400 (1st Cir. 2000); *Papago*, 723 F.2d at 953)); November 1 Order, 93 F.E.R.C. at 61,359.

[128] *Citing* 16 U.S.C. §§ 824d, 824e (2000).

interest" standard is applied to market-based rate contracts.[129]

ii. Response

82. Trial Staff points out that, after determining that none of the Respondents possessed the ability to exercise market power, the Commission granted all of the Respondents in this proceeding market-based rate authority. Trial Staff argues that, therefore, by definition the rates, terms and conditions of the actual contracts that Respondents negotiated in the market place are deemed just and reasonable. Trial Staff concludes that the need for prior Commission approval of these contracts has been met because the rates, terms and conditions included within these agreements are presumed just and reasonable. Trial Staff claims that Snohomish is taking issue not only with the determination that the *Mobile-Sierra* "public interest" standard applies but also with the validity of market-based rates generally.

83. Sellers argue that Snohomish misapprehends and/or seeks to collaterally attack the Commission's established notice and filing requirements and how they apply to market-based rates. They state that the application of the *Mobile-Sierra* doctrine cannot depend on the filing and approval of a contract if no such approval is available from, much less required by, the Commission. Sellers contend that Snohomish fails to recognize the Commission's discretion to authorize

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[129] It asserts that, in FP&L, 67 F.E.R.C. at 61,398, the Commission rejected the notion that it is or should be bound by the "public interest" standard when it initially reviews a contract. *See also Northeast Utilities*, 66 F.E.R.C. at 62,082; Pennsylvania Electric Co. v. F.E.R.C., 11 F.3d 207, 210 (D.C. Cir. 1993).

and implement its own filing requirements[130] and the sound policy decision behind the Commission's decision not to require individual market-based rate contracts to undergo additional review before they can become effective.[131]

iii. Commission Determination

84. As noted in GWF,[132] if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of market-based rate authority (*i.e.*, the original acceptance of the market-based rate tariff) a pointless exercise of no value to anyone. A new determination concerning the justness and reasonableness of a long-term service agreement is therefore unnecessary because such a determination has, in effect, already been made in the acceptance, and continuing effectiveness, of the market-based rate tariff pursuant to which a long-term service agreement is filed. The required mechanisms for ensuring that market-based rates are just and reasonable are in place: (1) prior to selling at market-based rates, sellers are required to file their proposed market-based rate tariffs for Commission review and demonstrate that they lack generation and transmission market power and control no other barriers to entry and that there is

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[130] *Citing* 16 U.S.C. § 824d(c) (2000).

[131] *Citing* GWF Energy LLC and Southern Co. Servs. Inc., 97 F.E.R.C. ¶ 61,297 at 62,391 (2001), *reh'g denied*, GWF Energy LLC, 98 F.E.R.C. ¶ 61,330 (2002) (GWF), appeal docketed sub nom. Public Utilities Commission of California v. F.E.R.C., No. 02-1108 (D.C. Cir. filed Apr. 12, 2002), dismissed June 18, 2002.

[132] GWF, 98 F.E.R.C. at 62,390-91.

no affiliate abuse or reciprocal dealing; and (2) sellers file triennial updates thereafter. If Snohomish were correct, no contract made under market-based authority would protect the parties' contractual expectations as envisioned by the U.S. Supreme Court in *Mobile-Sierra*. Moreover, the Commission has expressly rejected this proposition[133] and expressly excluded from the subjects set for hearing issues concerning the Commission's policies on granting market-based rate authority or on regulation of sellers with such authority.[134] Accordingly, we reject this exception.

b. Authority to Approve Market Based Rates

i. Argument

85. Snohomish claims that the Partial Initial Decision exceeds the Commission's authority to approve market-based rates by allowing rates that are unreasonable, imposing on customers the burden of proving that markets were not competitive, and presuming that market-based rates alone produce competition which results in virtually any price falling within the zone of reasonableness.

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[133] *See GWF*, 98 F.E.R.C. at 62,390-91; State of California ex rel. Lockyer v. British Columbia Power Exchange Corp., 99 F.E.R.C. ¶ 61,247 at 62,063 (2002), *reh'g denied*, 100 F.E.R.C. ¶ 61,295 (2002), appeal filed sub nom. State of California v. F.E.R.C., No. 02-73093, 9th Cir.

[134] April 25 Order, 99 F.E.R.C. at 61,384.

ii. Response

86. Trial Staff notes that the ALJ recognized that valid, market-based rates are just and reasonable rates unless the public interest requires that they be changed. Trial Staff also points out that the FPA and Natural Gas Act (NGA) place the burden of proof on those advocating a change in the status quo. Trial Staff argues that, because Complainants seek to abrogate or modify the instant contracts, they bear the burden of proof which the Commission has stated is a "heavy burden" given the request to modify contracts which were entered into voluntarily in a market-based rate environment.[135]

iii. Commission Determination

87. Market-based rates are authorized based upon a finding that a seller lacks market power and that, therefore, the seller's rates will be just and reasonable. Over time, the rates in a specific contract may become unjust and unreasonable. If the contract rates become unjust and unreasonable (*i.e.*, not what a competitive market would produce) and the contract does not permit a "just and reasonable" review, the contract rates over the life of the contract may be changed only if found to be contrary to the public interest pursuant to the *Mobile-Sierra* doctrine.[136]

88. In this proceeding, CDWR adopted a contractual arrangement under which the Commission maintains the ability under Section 206 of the FPA to replace

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[135] April 25 Order, 99 F.E.R.C. at 61,383.

[136] *Sierra*, 350 U.S. at 355.

rates only if they are contrary to the public interest. As stated in the April 25 Order, the burden of proof in this case is a "heavy burden" given that the contracts were entered into voluntarily in a market-based rate environment.[137] Complainants have not met their "heavy burden" because they have not shown that the rates in the instant contracts are contrary to the public interest. Therefore, we dismiss this exception.

c. Legislative History of the FPA

i. Argument

89. Snohomish argues that the legislative history of the FPA indicates that Congress did not intend to grant private contracts, including independently negotiated bilateral contracts, immunity from the Commission's oversight responsibilities. Snohomish also contends that the Commission's prior rulings and the legislative history of the Energy Policy Act of 1992 (Energy Policy Act) indicate that, even though Congress intended to promote competition in the industry and the electricity markets have become more competitive than when the FPA was first enacted, Congress did not intend to alter the Commission's Section 205 and 206 authority to modify or terminate jurisdictional contracts and/or rate schedules.[138]

ii. Response

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[137] April 25 Order, 99 F.E.R.C. at 61,383.

[138] *Citing* City of Bedford, Virginia, et al. v. Appalachian Power Company, 87 F.E.R.C. ¶ 61,037 at 61,139 (1999).

90. Trial Staff states that private contracts are not immune from Commission oversight. It argues that the Commission would order an appropriate remedy if the contracts were not in the public interest because they imposed an excessive burden on customers, were unduly discriminatory or were entered into as a result of market power or market manipulation. Trial Staff contends that the issue is not whether the Commission will perform its regulatory duties but whether Complainants have carried their burden of proof to warrant contract reformation.

iii. Commission Determination

91. We agree that private contracts are not subject to immunity from the Commission's oversight responsibilities. Indeed, the *Mobile-Sierra* doctrine recognizes that, even if parties agree to limit their unilateral rights to amend contracts, they cannot eliminate the Commission's indefeasible right to replace rates that are contrary to the public interest.[139] However, under long-standing court precedent, the fact that a contract rate may no longer be just and reasonable does not equate to a demonstration that the contract is contrary to the public interest. We also agree that nothing in the Energy Policy Act altered the Commission's Section 205 and 206 authority to amend contracts. The Commission is following the

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[139] *See Papago*, 723 F.2d at 953. *See also id.* at 954 ("The Commission's obligation to insure that rates do not violate that prescription [that they are in the public interest] is imposed for the direct benefit of the public at large rather than (like the prescription of just and reasonable rates) for the direct benefit of the seller and purchaser; and it therefore cannot be waived or eliminated by agreement of the latter.")

requirements of Sections 205 and 206, as interpreted by the *Mobile-Sierra* line of cases, in analyzing the evidence before us. The fact is that Complainants have failed, based upon this record, to show that the contracts at issue are contrary to the public interest. Therefore, we deny this exception.

5. Implied Waiver of Section 206 Rights

a. Argument

92. Snohomish claims that the ALJ's conclusion that parties can waive Section 206 rights by implication is contrary to established precedent.[140] It also argues that the ALJ's reliance on *San Diego Gas & Electric Co. v. Public Service Co. of New Mexico*[141] is misplaced because: (1) the Commission there concluded that the parties had contemplated the possibility of a rate decrease but prohibited the filing for such a decrease as an express and integral part of the bargain struck by the contracting parties; and (2) the contract there had been approved by the Commission as just and reasonable, and the Commission found that contractual language could not restrict the Commission's review of a contract upon initial filing.

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[140] *Citing* Sithe/Independent Power Partners v. Niagara Mohawk Power Corp., 76 F.E.R.C. ¶ 61,285 at 62,458 (1996); *Boston Edison*, 233 F.3d at 67.

[141] June 1 Order, 91 F.E.R.C. ¶ 61,233.

b. Response

93. Trial Staff and Sellers responds that the case law is unambiguous that, when contracts are negotiated in the absence of clear contractual language allowing unilateral contract modification under Section 206, the party seeking change must meet the "public interest" standard.

c. Commission Determination

94. The Complainants in this case were given an opportunity to provide evidence demonstrating the parties' intent to apply the "just and reasonable" standard to the contracts at issue. Instead, they argued at hearing as well as in their post-hearing briefs that the "just and reasonable" standard and the "public interest" standard merge because it is contrary to the public interest to charge unlawful rates to the public. The Commission and court precedent establish that the "public interest" standard and the "just and reasonable" standard of review are two separate standards and thus cannot be collapsed into one standard of review.[142] The weight of the record evidence on the circumstances surrounding execution of the challenged contracts demonstrates that the parties intended the "public interest" standard of review to apply to the contracts at issue. On this basis, we therefore affirm the Initial Decision's conclusion that the "public interest" standard of review

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[142] *See, e.g., Sierra* at 354-5 (1956) and Southern California Water Co. v. Southern California Edison Co., 90 F.E.R.C. ¶ 61,287 (2000).

applies to these particular contracts and deny exceptions on this issue.

6. Satisfaction of the *Mobile-Sierra* Standard

a. Argument

95. Snohomish contends that the "public interest" standard is met here because of the devastation inflicted on electric customers across the West by the rates, terms and conditions contained in the long-term contracts that grew out of the crisis. It claims that evidence presented by Complainants establishes that the expectation that the California spot markets would continue to spiral out of control indefinitely forced CDWR to accept long-term contracts at prices and with terms and conditions far less favorable than would have resulted from a dysfunctional market. Snohomish concludes, therefore, that customers will be forced to bear excessive burdens arising from the market dysfunction into the future unless the Commission modifies these contracts.

b. Response

96. Trial Staff points out that the determination of whether the "public interest" standard has been met was beyond the scope of the Partial Initial Decision.

c. Commission Determination

97. In its January 10 Order, the Commission limited the scope of the Partial Initial Decision to a determination of which standard of review to apply to contracts without explicit *Mobile-Sierra* language and

stated that the Commission would determine whether the appropriate standard had been met based upon the evidence presented. We discuss above whether the "public interest" standard has been met and conclude that Complainants have not met their burden of proof.

7. Alleged Unlawful Deregulation of Electricity Sales

a. Argument

98. Universal contends that the imposition of the "public interest" standard on a contract that is silent as to the parties' Section 205 and 206 rights to unilaterally modify the contract constitutes the unlawful deregulation of electricity sales because it allows sellers of electricity to collect rates and charges that are not just and reasonable, in contradiction with the express words of the FPA.

b. Response

99. Trial Staff counters that, while Sections 205 and 206 require that all rates be just and reasonable, that requirement cannot be read in isolation when a freely-negotiated contract prohibits or limits changes to that contract. It contends that the only interpretation of "just and reasonable" that affords meaning to the language of such a contract, the established *Mobile-Sierra* doctrine and the intent of the parties is that the contract price is the just and reasonable rate. Trial Staff argues that a contract price based upon market-based rates would be just and reasonable if it is consistent with the seller's market-based rate authority. It claims that such a just and reasonable rate may become unjust and unreasonable only if one

of the three prongs of the "public interest" test is met. It concludes that other measures of justness and reasonableness, such as traditional cost-of-service calculations, do not apply, unless the "public interest" test is met first.

100. Sellers contend that collapsing the "public interest" standard into the "just and reasonable" standard would be an arbitrary and capricious abandonment of years of decisions upholding contract sanctity and applying the "public interest" standard when buyers seek to abrogate fixed-rate contracts.

c. Commission Determination

101. As discussed above, if rates become unjust and unreasonable (*i.e.*, not what a competitive market would produce over the life of the contract) and the contract does not permit a "just and reasonable" review, they may be changed only if found to be contrary to the public interest pursuant to the *Mobile-Sierra* doctrine.[143] Under the contracts at issue, the Commission maintains the ability under Section 206 to replace rates that are contrary to the public interest; however, it does not have the power to replace rates that are unjust, unreasonable, or unduly discriminatory or preferential to the detriment of the contracting purchaser.[144] Complainants have not shown that the rates in the instant contracts are contrary to the public interest. Therefore, we deny this exception.

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[143] *Sierra*, 350 U.S. at 355.

[144] *See Papago*, 723 F.2d at 953.

The Commission orders:

(A) The Partial Initial Decision is hereby affirmed, as discussed in the body of this order.

(B) The complaints are hereby denied.

(C) Complainants' motion requesting order to approve withdrawal of complaints with prejudice as to Williams is granted, as discussed in the body of this order.

(D) Complainants' motion to reopen the record is hereby granted in part and denied in part, as discussed in the body of this order.

(E) Complainants' motion to take official notice is hereby denied, as discussed in the body of this order.

(F) Complainants' motion to lodge is hereby denied, as discussed in the body of this order.

By the Commission. Chairman Wood concurred in part with a separate statement attached. Commission Massey dissented with a separate statement attached. Commission Brownell concurred with a separate statement attached.

s/ Magalie R. Salas
Magalie R. Salas,
Secretary.

Appendix A

LIST OF CONTRACTS SET FOR HEARING

Public Utilities Commission of the State of California v.
Sellers of Long Term Contracts to the California Department of Water Resources
Docket Nos. EL02-60-000 and EL02-62-000

I. Contracts for which the issue of the applicable standard of review was summarily decided:

Seller's Name	Contract Date
Williams Energy Marketing & Trading Company	2/21/2001
Allegheny Energy Supply Company, LLC	3/23/2001
Allegheny Energy Supply Company, LLC	4/20/2001
Soledad Energy, LLC	4/28/2001
GWF Energy, LLC	5/11/2001
Mirant Americas Energy Marketing, LP	5/22/2001
Coral Power, L.L.C.	5/24/2001

II. Contracts for which the issue of the applicable standard of review was set for hearing:

Seller's Name	Contract Date
El Paso Merchant, L.P.	2/13/2001
Morgan Stanley Capital Group, Inc.	2/14/2001
Dynegy Power Marketing, Inc.	3/02/2001

Imperial Valley Resource Recovery Company, L.L.C.	3/13/2001
Alliance Colton, LLC	4/23/2001
Sempra Energy Resources	5/04/2001
PG&E Energy Trading-Power, L.P.	5/31/2001

Appendix B

The evidentiary hearing began on December 2, 2002 and concluded on December 12, 2002.

On December 17, 2002, the Commission denied Allegheny's emergency motion for summary dismissal of the complaints regarding its contracts which had been filed on October 29, 2002.[145] To expedite resolution of the proceeding as to Allegheny and other parties whose contracts contained explicit *Mobile-Sierra* provisions, the Commission directed the ALJ to omit the initial decision on this issue and certify the record directly to the Commission. On December 24, 2002, the ALJ certified the record of this portion of the proceeding directly to the Commission, as directed, and proceeded to evaluate the record for the purpose of preparing an initial decision on the contracts of the remaining sellers.[146]

On January 10, 2003, in response to motions for partial summary disposition on the applicable standard of review for Dynegy's, El Paso's, Sempra's and Morgan Stanley's long-term contracts with CDWR, the Commission directed the ALJ to determine the applicable standard of review for the contracts which did not contain explicit *Mobile-Sierra* language and, if the ALJ found the "public interest" standard applied, to certify the record of those contracts directly to the Commission for consideration of all remaining issues

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[145] December 17 Order, 101 F.E.R.C. ¶ 61,293.

[146] Public Utilities Commission of California v. Sellers of Long Term Contracts, 101 F.E.R.C. ¶ 63,034 (2002). *See also* Errata Notices dates 12/31/02 and 1/10/03.

in the case.[147] On that same date, initial post-trial briefs were filed by Complainants, Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley, Sempra, Respondents jointly, Trial Staff and Universal.

On January 13, 2003, Complainants filed a joint notice of withdrawal of their complaints with prejudice as to Williams and a joint motion requesting an order to approve such withdrawal. On January 28, 2003, Pacific Gas and Electric Company (PG&E) filed an answer to the notice of withdrawal.

On January 16, 2003, the ALJ issued a partial initial decision finding that the "public interest" standard applies to all the contracts which did not contain explicit *Mobile-Sierra* language.[148] On January 17, 2003, the ALJ certified the record to the Commission. On January 24, 2003, the Secretary clarified that the parties were directed to submit their reply briefs directly to the Commission no later than January 27, 2003 and that the Commission would accept the initial briefs filed with the ALJ on January 10, 2003. On January 27, 2003, reply briefs were filed by Complainants, Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley, Sempra, Respondents jointly, Trial Staff and Universal.

Briefs on exceptions to the Partial Initial Decision were filed by the CPUC and the CEOB. Briefs opposing exceptions were filed jointly by Allegheny, Coral, Dynegy, El Paso, Mirant, Morgan Stanley and Sempra and by Trial Staff.

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[147] January 10 Order, 102 F.E.R.C. ¶ 61,025.

[148] Partial Initial Decision, 102 F.E.R.C. ¶ 63,013.

On February 24, 2003, Complainants filed a motion to lodge a complaint which they filed in the Superior Court of California.

On March 3, 2003, Complainants sought to supplement the record in this proceeding with the market manipulation/abuse evidence submitted in Docket No. EL00-95, *et al.* On March 11, 2003, Respondents jointly filed a motion to strike this submission or, in the alternative, a motion for leave to respond to the supplemental submission.[149] Respondents also individually opposed and filed evidence, including new testimony, in response to Complainants' supplemental submission.[150] On March 20, 2003, Complainants filed reply comments. On March 25, 2003, Complainants filed an answer in response to the motion to strike and Allegheny's and Reliant's response to their supplemental submission. On March 26, 2003, Complainants filed a motion to strike submissions filed by Mirant and Sempra. On April 2, 2003, Allegheny, Coral, Dynegy, El Paso, Mirant and Sempra filed a motion to strike or, in the alternative, a motion for leave to respond to Complainants' reply comments. On April 9, 2003, Mirant and Sempra filed a response to Complainants' motion to strike their submissions. On April 10, 2003,

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[149] On March 18, 2003, Reliant Energy Services, Inc. and Reliant Energy Power Generation, Inc. (collectively, Reliant), an intervenor in this proceeding, responded to Complainants' supplemental submission.

[150] Complainants and Respondents also submitted indexes that had been requested to be filed in Docket Nos. EL00-95, *et al.*, pursuant to a Commission order. *See* February 10 Order, 102 F.E.R.C. ¶ 61,164.

Complainants filed a response to the motion to strike their reply comments.

On April 16, 2003, Complainants filed a Motion for Disclosure of Alleged Off-The-Record Communications and Request for Oral Argument. On April 18, 2003, Respondents filed a Motion for Leave to File an Answer and Answer to the Request for Oral Argument. On April 18, 2003, a notice was issued scheduling oral argument for May 15, 2003. On April 22, 2003, the Commission filed a summary of the events relating to the alleged off-the-record communications, and, on April 23, 2003, the Commission issued an order finding that these were not inappropriate communications;[151] therefore, Complainants' motion for disclosure is now moot.

On April 22, 2003, Complainants filed a Motion to Reopen the Record or Take Official Notice of Evidence of Market Abuse. Coral and Sellers filed answers in opposition to this motion.

On May 15, 2003, the Commission held oral argument in this proceeding (Oral Argument).

On June 11, 2003, in Docket Nos. EL02-60-000 and EL02-62-000, Complainants, Allegheny and Allegheny Trading Finance Company (collectively, the Settling Parties) filed a settlement agreement (Allegheny Settlement Agreement).[152] On June 13,

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[151] Nevada Power Company, *et al.*, v. Enron Power Marketing, Inc., *et al.*, 103 F.E.R.C. ¶ 61,080 (2003).

[152] On that same date, in Docket No. ER01-1847-001, Complainants and Allegheny filed an Amended and Restated Agreement.

2003, a notice was issued shortening the comment period on the Allegheny Settlement Agreement.[153]

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[153] The comment period on the Amended and Restated Agreement was shortened also.

Appendix C

Summary of Parties' Arguments Regarding Remaining Substantive Issues

8. Impact of the Spot Market on the Forward Market

a. Initial Briefs

i. Complainants

Complainants allege that the prices CDWR agreed to pay in the first five months of 2001 for electricity to be delivered in the remainder of 2001, all of 2002, and into 2003 were enhanced by the expectation that the price-inflating effects of the flaws in the spot markets would not fully attenuate until 2004. Complainants assert that prices were high in the spot market because supply was tight relative to demand and that tightness of supply, in the absence of firm regulatory safeguards, created conditions in which the withholding of even small amounts of supply would substantially raise prices. They contend that tight supply in the electricity markets is the condition that activates and can be exacerbated by market flaws.

Complainants state that forward prices are based upon expected future spot prices, and forward markets are necessarily affected by expected dysfunction in the spot market. They argue that the forward prices that prevailed prior to June 2001 for delivery of electricity prior to 2004 reflected a premium above the price that would have been expected based upon the interaction of supply and demand in a functioning and competitive market as a

result of the expected continued effects of spot market dysfunction. They contend that the risk premium analysis provided does not explain the gap between the fundamentals forecast and the actual forward prices. They claim that their expert confirmed that the gap can only be explained by the market's expectation of continued dysfunction in the spot market. They assert that changes in NOx regulations cannot explain the drop in forward prices. They state that new generation would not have an effect on forward prices. They argue that expectations of economic performance remained the same during the relevant two week period or that there was no unexpected news about nuclear or hydro conditions announced in late May that would have affected forward prices. They claim that the exercise of market power and changes in regulatory approach and CDWR's long-term contracting also affected forward prices.

Complainants contend that the credit concerns with the IOUs that caused QFs to go offline were a dysfunction, not a market fundamental, and adversely affected CDWR's negotiations.

Complainants claim that the structure and pricing of the long-term contracts reflect the impact of the dysfunctional spot market. They contend that over time the back-end loaded contracts will provide total revenues that match or exceed the expected spot prices, including the high 2001 and 2002 expected prices, over the life of the contract. They assert that sellers also spread out high prices for 2001 and 2002 by increasing the number of megawatt hours delivered in the back-end years. They state that contract negotiations were driven by crisis conditions that were a direct result of the dysfunctional spot market. They

argue that the forward price curves established the floor for the negotiation of the instant contracts, and the contracts are overall priced higher than the expected spot prices would otherwise suggest.

ii. Trial Staff

Trial Staff asserts that the high prices in California's long-term, bilateral energy markets may be attributable to three factors: (1) flaws in the spot markets; (2) competitive market fundamentals; or (3) the exercise of market power or market manipulation. Trial Staff notes that the Commission placed the third outside the scope of the hearing due to the investigation in Docket No. PA02-2-000. Trial Staff's witness testified that: (1) the Commission issued orders addressing most of the flaws it identified in the California spot markets prior to the execution of the contracts at bar; (2) market fundamentals do not improperly affect forward contract prices, but rather produce price signals that such contracts should reflect; and (3) the Complainants failed to meet their burden because they did not distinguish adequately between the adverse effects of any flaws that may have remained in the spot markets and the effects of market fundamentals on the long-term, bilateral markets.

Trial Staff argues that Complainants did not show that expected future prices in the dysfunctional ISO and PX spot markets adversely affected the prices of the forward contracts entered into by CDWR, as the Commission required. Trial Staff asserts that the parties executed the contracts at issue between February 13, 2001 and May 24, 2001, after the PX spot market suspended operation at the end of January 2001. Trial Staff contends that Complainants' witness

recognized that PX spot market prices played no role in determining the forward price curves upon which the long-term contracts were based. Trial Staff concludes, therefore, that market participants could have no expectations of future PX spot market prices in determining the prices of the long-term contracts signed between February and May 2001.

Trial Staff claims that Complainants did not produce any evidence explicitly linking the ISO spots markets with the contested contracts, only providing testimony about spot market prices in general.

Trial Staff asserts that the Commission took actions to correct most of the flaws in the California spot markets that gave rise to dysfunctions prior to the execution of the contested contracts, thus eliminating any effects of the flaws on these forward contracts. Therefore, Trial Staff concludes that, even if Complainants had offered evidence on the specific effects of the ISO and PX spot markets on the contracts at issue, as required by the hearing order, they would not have been able to demonstrate any substantial adverse effect from spot market dysfunctions because the Commission took preemptive action to eliminate the dysfunctions prior to the time the instant contracts were executed. Trial Staff argues that, once the Commission acted, market participants were (or should have been) aware that this critical dysfunction that created over reliance on spot markets would be less of a factor affecting prices.

Trial Staff contends that the remaining reasons for prices to continue to be relatively high are: (1) competitive market forces (*i.e.*, market fundamentals); (2) inadequate retail demand responsiveness; (3)

possibly the exercise of market power; and (4) market participants may have expected the spot market flaws identified by the Commission to continue, despite Commission action to remedy them, thus affecting their calculation of forward prices. Trial Staff asserts that forward contracts are supposed to reflect competitive market forces on prices (*i.e.*, prices are expected to and must rise to induce the investment in new capacity that is needed to serve customers adequately). Trial Staff claims that, after December 15, 2000, prices in the spot market were becoming less and less reflective of a dysfunctional market design and thus more reflective of competitive market conditions. Therefore, Trial Staff concludes that Complainants must identify and segregate the portion of the forward contract rates at issue which was due to the effect of competitive factors and the portion which was due to other effects. Trial Staff contends that if these distinctions are not made Complainants risk overestimating the effect of any residual spot market flaws or exercise of market power on the long-term contracts.

Trial Staff argues that the position of Complainants' witness that the high contract prices must either be explained totally by a market fundamentals "hypothesis" or a market dysfunction "hypothesis" is not tenable. Trial Staff asserts that the simple correlation between spot and forward prices and a synchronous decline does not prove or even suggest that high spot prices caused forward prices to be high.

Trial Staff asserts that to demonstrate the magnitude of the dysfunction on the contracts at issue Complainants mistakenly rely on their expert's testimony which erroneously estimated "the level of overcharge[s]" in the contracts at issue "by comparing the expected contract costs with the costs of an alternative source of generation." Trial Staff notes that, after acknowledging that he made computational errors, the expert which provided this testimony filed supplemental testimony which conceded that, when corrected, his analysis would not show "that the contracts are priced above long-run competitive prices."

Trial Staff concludes that a review of Complainants' evidence shows that they failed to meet their heavy burden to demonstrate that dysfunctional California spot markets adversely affected the long-term bilateral markets, and, even if they had, they failed to show the extent of any such effect that would warrant the modification of the instant contracts.

iii. Sellers

Sellers[154] argue that Complainants have failed to show that the dysfunctional spot markets adversely affected the long-term bilateral markets. Sellers claim that Complainants did not present any empirical or statistical analysis attempting to prove that the

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[154] On January 10, 2003, Dynegy, El Paso, Morgan Stanley and Sempra filed a joint initial hearing brief which was virtually identical, expect for its discussion of the applicable standard of review, to a joint initial hearing brief filed by Allegheny, Coral and Mirant on that same date. Therefore, the following discussion of their initial hearing briefs will refer to these Respondents collectively as "Sellers."

dysfunctional ISO spot markets in any way affected the long-term bilateral markets.

Sellers contend that Complainants' primary expert did not present any analysis of ISO spot markets, looking instead at bilateral spot markets. Sellers state that the expert failed, therefore, to provide substantive evidence concerning the relevant spot markets.

Sellers note that the only empirical analysis that Complainants offered in their direct case when corrected for numerous and admitted errors showed that the rates in the challenged contracts do not exceed long-term competitive prices.

Sellers contest Complainants' expert's emphasis on the supposedly sudden and dramatic two-week decline in bilateral spot and forward prices during late May and early June 2001 relied upon to demonstrate that spot market dysfunction adversely affected forward power prices. Sellers respond that the "two-week" price collapse theory is factually incorrect when viewed in the context of overall price trends throughout the spring of 2001 and, therefore, is not dispositive.

Sellers argue that none of the external factors cited by Complainants' expert support his theory that sudden changes in certain "external factors," such as political developments, explained the supposedly sudden and dramatic collapse in spot and forward prices better than market fundamentals.

Sellers challenge Complainants' experts' broad definition of "dysfunction" which included any market flaw combined with scarcity and a related notion of a

"dysfunction magnifier." Sellers argue that this definition of dysfunction contradicts Commission precedent and well-established economic principles as noted in Sellers' economists testimony. Sellers also argue that the expert's "dysfunction magnifier" was unsupported by any empirical analysis actually proving that dysfunctions in ISO spot market affected forward markets.

Sellers contend that Complainants ignored the price forecasts that CDWR's own consultants at Navigant Consulting (Navigant) developed while the challenged contracts were being negotiated and executed. Sellers note that a version of these price forecasts, one which never contained any "dysfunction premium," substantially exceeded the market-based forward price curves for electricity that were publicly available at the time for all periods other than summer 2001 and that even the difference for the summer 2001 period was small in all but one month.

Sellers also claim that, although the expert admitted that forward natural gas prices, emission allowance costs and other market fundamentals are critical to understanding forward electric prices, he never comprehensively analyzed these market fundamentals in preparing his pre-filed testimony and, thus, had little or no basis for opining that anything other than fundamentals drove forward electric prices.

Sellers also assert that, even if Complainants had shown that dysfunctional ISO spot markets had some adverse effect on the long-term bilateral markets, they did not show that the effect was of sufficient magnitude to warrant modification of the instant contracts.

Sellers argue that their witness demonstrated that the primary drivers of forward prices were market fundamentals, not dysfunctions in the ISO spot markets. Sellers also argue that forward contracts were not symptomatic of dysfunctions in the ISO spot markets, rather they helped cure any dysfunctions that existed in those markets.

iv. Dynegy

Dynegy asserts that Complainants did not offer direct analysis of underlying market fundamentals to support their assertions that dysfunction in the forward markets affected Dynegy's contract price, did not present evidence that evaluated the contract price and did not address Dynegy's witness' contention that the price terms associated with the fixed and system contingent capacity and energy were not controversial or objected to during the contract negotiations.

v. Mirant

Mirant contends that the expert testimony presented by Complainants crumbles when applied to the Mirant Agreement and, in fact, supports a finding that the assumed dysfunctional California ISO spot markets has no adverse effect on the forward markets at the time the Mirant Agreement was negotiated and executed.

vi. Sempra

Sempra argues that it does not consider current spot prices in pricing electricity products and that alleged dysfunctions in the ISO spot markets did not influence Sempra's bids to CDWR. It asserts that forward price curves obtained from brokers and

traders for electricity and natural gas played a significant role in Sempra's offer prices to CDWR. Sempra also took into consideration (1) construction and operational costs associated with developing its generation assets, (2) statements by California representatives suggesting that CDWR was looking for prices in the $50-$60 per megawatt-hour price range, (3) losses that Sempra would incur by making sales at below-market rates for the summer of 2001, and (4) the unique credit risks entailed in entering into a transaction with CDWR without credit assurances typically required by Sempra.

Sempra argues that Complainants have conceded that they cannot show that the dysfunctional ISO spot markets had any discernible effect on long-term bilateral contract prices for delivery beyond some unspecified point "into 2003." Sempra contends that, even setting aside Complainants' witness' unsubstantiated estimates of his dysfunction premium for 2001 through 2003, the magnitude of his dysfunction premium as applied to the Sempra Agreement falls short of that which would be required for Complainants to meet their heavy burden in this regard. It claims that an alleged "overcharge" of 2.8 to 3.6 percent above a purported ideal rate cannot justify the extraordinary remedy of contract modification under any standard of review.

vii. Universal

Universal argues that there are two conditions that must be met for market-based rates to be just and reasonable: (1) there must be a competitive market and (2) the resulting prices must fall within the same zone of reasonableness as cost-based rates. It argues

that the long-term bilateral market was not competitive because it was dysfunctional due to the market structure and the pattern of prices is in a range which indicated that market forces were not driving the prices to a "market clearing," marginal cost level. It contends that the dysfunction in the spot market did affect the long-term markets.

Universal challenges the evidence tendered by Trial Staff because it claims that: (1) its witness admitted that he did not perform any study to determine why prices were so high in the California market in 2001; (2) its witness admitted that the long-term market might have been affected by the dysfunction in the spot market, but he decided not to investigate the subject; (3) its witness admitted that he considered only a few and selective portions of the evidence offered by Complainants and Sellers; and (4) its witness did not examine the evidence on the California market that was accumulated by Commission Staff and made available not only to the Commission but also to other agencies such as the U.S. Securities and Exchange Commission, U.S. Department of Justice and Federal Trade Commission. It criticizes other testimony which relied on this witness.

b. Reply Briefs

i. Complainants

Complainants charge that the lack of installed plants in California was a direct result of market flaws. They contend that these market flaws were also evidenced by a lack of incentives for new construction, changes which would affect the forward markets.

They state that the combination of existing market flaws and tight supply led to sellers exercising market power through withholding supply and driving up prices. Complainants argue that the fact that they were precluded from investigating or offering evidence of market abuse created a "catch-22" situation.

Complainants allege that the Commission's November and December 2000 orders did nothing to relieve prices, but rather, caused the spot and forward markets prices to rise. They assert that the result was contracts priced at or above the forward curves, suggesting that there was an expectation of continued dysfunction driving forward prices until 2004.

Complainants assert that Respondents mischaracterize Navigant's proxy price model and its purpose. They argue that the proxy price model does not, as Respondents state, represent a forecast of competitive prices. They claim that Navigant's model is neither a forecast of market fundamentals nor an estimate of future competitive prices, but rather a conservative proxy with which CDWR could estimate revenue requirements for electricity purchases.

ii. Trial Staff

Trial Staff argues that Complainants have revealed the weakness of their case by switching their primary reliance from their own witnesses' flawed analyses to a graph created by a witness for Dynegy to support their claim that a "dysfunctionality premium" existed in 2001 in the forward markets. Trial Staff explains that the graph displays a gap between the average forward prices and the model's forecasts for 2001 and 2002 and that Complainants contend that

the gap between the two curves on the graph, which Complainants modified and included in their Initial Brief, shows that forward prices were "infected" by spot market dysfunctions. Trial Staff states that the graph, modified or unmodified, shows no such thing. Trial Staff argues that, simply recognizing that a gap exists between a curve depicting forward on-peak prices at a particular California delivery point and a curve depicting prices forecasted by a commercial software model, does not conclusively establish the existence of a "dysfunctionality premium" in forward markets.

Trial Staff asserts that Complainants' analysis of spot and forward prices for a particular two-week period in 2001 failed to produce any proof that spot market dysfunction actually affected the forward market. It notes that Complainants assert that their witness independently confirmed that the gap displayed in Exhibit DYN-31 can only be explained by expectations of continued dysfunction in the spot market. Trial Staff argues that the problem with this approach is that it does not demonstrate that the dysfunctional ISO and PX spot markets affected the forward markets and, at best, merely shows that spot and forward prices moved together during those two weeks. Trial Staff also argues that Complainants do not demonstrate the extent to which these price levels were the result of competitive market forces and the extent to which they were the result of other causes, such as market flaws.

Trial Staff argues that the fact that some QFs did not sell generation to California utilities because of credit concerns fails to establish a causal relationship between spot market dysfunction and the forward

contracts at issue. Trial Staff states that, by characterizing the credit concerns as a dysfunction, Complainants contend such withholding of power by QFs pushed forward prices up, thus proving their witness' conclusion that spot market dysfunction affected forward prices. Trial Staff asserts that Complainants' argument makes little sense because QFs did not sell their output into the ISO and PX spot markets; instead, pursuant to Section 210 of the Public Utility Regulatory Policies Act, they sold power directly to electric utilities. Thus, Trial Staff concludes that QFs did not have a direct relationship to the spot markets. Trial Staff points out that, as explained in the testimony submitted on behalf of Respondents Morgan Stanley, Sempra, Mirant and Allegheny, beginning in December 2000, the Commission relaxed its restrictions on QFs, allowing them to sell excess output through bilateral contracts.

Trial Staff claims that Complainants were unable to prove their assertion that the pricing structure of the forward contracts, some of which contain levelized prices, was driven by the dysfunctional spot markets operated by the ISO and PX. Trial Staff asserts that the fact that the contracts at issue may have been priced at or above the forward price curves does not support Complainants' contention that the prices in the contracts incorporated the dysfunctions in the spot market and therefore must be modified to achieve just and reasonable rates.

Trial Staff states that now Complainants contend that a measure of the excessive burden on ratepayers can be found in Appendix C to their Initial Brief, which they admit is a "rough" quantification of the "dysfunctionality premium." Trial Staff argues

that, not only is it too late for Complainants to attempt to quantify (for the first time) this measurement of the alleged "overcharges," but also the theory upon which they rely is flawed because there has been no showing that the forward price curves where the product of the dysfunctional spot market.

iii. Sellers

Sellers argue that Complainants did not and cannot demonstrate that the dysfunctional spot markets had an adverse effect on the long-term bilateral markets in California. Sellers contend that Complainants' analysis on this point is flawed because it is based upon misguided assumptions and incorrect price comparisons, including a misuse of the GE MAPS results presented by one of Sellers' witnesses. Sellers assert that Complainants constructed a faulty analysis of expected prices for 2002 (as of March 1, 2001) and then worked backwards to fill this evidentiary void by purporting to derive a dysfunction premium for 2001 forward prices. Sellers dismiss as mere theory Complainants' argument that changes in bilateral spot and forward prices during a two-week period in late May and early June 2001 demonstrated the existence of a dysfunction premium in the forward market prices. Sellers claim that Complainants' analysis regarding this two-week period fails to take into account critical changes in market fundamentals.

Sellers maintain that the evidence shows that the dysfunctional spot markets did not adversely affect the long-term contracts at issue in any material manner. Sellers assert that, contrary to Complainants' contention, scarcity alone is not a market dysfunction that affected the long-term

bilateral markets during 2001. Seller's state that prior Commission orders make clear that scarcity contributed to dysfunction in the ISO and PX spot markets only to the extent that it was combined with State-imposed restrictions on the IOUs that forced them to buy power exclusively in the PX spot markets. Sellers state that the Commission eliminated these State-imposed restrictions in January 2001, thereby eliminating this contributing factor to dysfunction in the residual ISO spot markets. Moreover, Sellers argue that even if market participants could exercise market power in the ISO spot markets during conditions of scarcity, it is virtually impossible to leverage such market power into the bilateral forward markets. Sellers state that doing so is especially difficult in the long-term bilateral markets because the market for forward contracts is not the final market available to either a buyer or seller (meaning that the buyer or seller can wait to buy or sell later in the forward or spot markets).

Sellers contend that Complainants failed to prove, under any relevant standard, that the effect of the dysfunctional ISO spot markets on long-term bilateral markets in California was of a magnitude warranting abrogation or modification of the challenged contracts. Sellers argue that Complainants have taken the position that they are entitled to relief if they show that the dysfunctional ISO spot markets had *any* effect on the contracts at issue and that such a position constitutes a collateral attack on the April 25 Order in this case, which requires Complainants to show an adverse effect of sufficient magnitude to warrant abrogation or modification. Sellers claim that, instead of making the required showing, Complainants rely upon a flawed benchmark analysis

and unsupported dysfunction premiums. In any case, Sellers assert that the contract costs are below the ten-year $70/MWH target sought and achieved by the CDWR and that CDWR's payments under the contracts did not exceed the level that the retail market was accustomed to paying.

iv. Allegheny

Allegheny claims that Complainants' contention that the Allegheny Agreement was priced above its forward curves is patently wrong. Allegheny states that CDWR obtained a just and reasonable price from Allegheny and agreed to compensate Allegheny for the substantial risks it assumed under the contract. Allegheny argues that, contrary to Complainants' misrepresentation, at the time of the negotiations, Allegheny's 11-year, $61MWh contract was priced at virtually the same level as its forward price curves and carried a de minimis $10 million dollar projected "cushion" over the entire life of the long-term fixed price contract. Allegheny argues that Complainants fail to mention that, based upon Navigant's then-current forward curves at the time of contracting and the swap-price methodology used by Mr. Koenig, the price of the Allegheny Agreement would have been $70/MWH. It concludes that, based upon CDWR's own forward curves, the Allegheny Agreement price of $61/MWH was substantially cheaper and priced far below expected spot prices, as projected in CDWR's own forward curves. Allegheny asserts that whether or not the contract was priced at or above the forward price curves at the time of Complainants' analysis does not take into account the fact that Allegheny, like CDWR, was a price taker in the volatile electricity

markets and therefore was taking on substantial risks for which compensation was appropriate.

Allegheny notes that Dynegy's witness' review of CDWR's contracts, to demonstrate that their forward price curves formed the floor for negotiations, analyzed only contracts entered on or before March 1, 2001 and therefore his study did not include the Allegheny Agreement which was signed on March 23,2001 and April 20,2001, respectively.

Allegheny states that the record shows the absurdity of Complainants contention that the Commission should "presume" that the Allegheny Agreement, on the day it was signed, was hugely profitable. First, it states that the record demonstrates that the Allegheny Agreement was not "hugely profitable" because it shows that the expected mark-to-market value, based upon the forward curves from which the price was derived, was a mere $10 million. Second, it points out that Mr. Koenig testified that Allegheny undertook numerous actions to perform under the CDWR contract which resulted in realized cash losses in the hundreds of millions of dollars.

Allegheny alleges that Complainants have not demonstrated that the harm, if any, to California from these contracts is of a magnitude warranting modification. Allegheny argues that Complainants' analysis of contract overcharges, as well as their conclusion that these overcharges harmed the State economy, are so flawed as to invalidate their conclusions.

Allegheny claims the corrected analysis of Complainants' evidence shows that the Allegheny

contracts produce savings to the State of $67.4 million or $92.5 million per year.

Allegheny asks the Commission to reject Complainants' arguments that the contracts should be reformed based on Respondents' legitimate performance costs because they are not the appropriate measure of the just and reasonable rates of the Allegheny Agreement. It claims that a seller's costs are not a relevant test for market-based rate authority or market-based transactions.

v. Dynegy

Dynegy argues that Complainants has not submitted any evidence that Dynegy's price was affected by spot market dysfunction. Dynegy submits that although the State argues that Dynegy's prices were developed based on forward price curves that were affected by spot market dysfunction, it has not submitted testimony analyzing Dynegy's prices and in fact declined to do so. Dynegy contends that allowing Complainants to now argue that they have a new approach to quantifying a dysfunction premium in Dynegy's prices is "unacceptable". Furthermore, Dynegy argues that Complainants' analysis is incorrect in that prices under the Dynegy contract are 10 to 25 percent less than the forward price curves at the time the contract was signed. Dynegy points out that under the contract Complainants have the benefit of falling gas prices and that this reduction in gas prices through October 2002 caused lower contract prices. To support its position, Dynegy states that its witness concluded that Dynegy's prices were driven by market fundamentals and exhibited no material influence of spot market dysfunction.

Dynegy also alleges that Complainants misconstrue several facts to cast Dynegy in a bad light. Among the facts misconstrued is the amount of capacity CDWR must buy under the Dynegy Agreement. Dynegy claims CDWR is only obligated to take 200-500 MWs and is not obligated for anything above that. Dynegy argues that Complainants' assertion that the tolling requirements of the Dynegy Agreement "places all gas risk on Dynegy" is false since gas prices have fallen providing the State with significant benefits. Dynegy also disputes the accuracy of Complainants' recalculation of its witness' estimation of Dynegy's contract price and attributing 2001 dysfunctionality premiums calculations to that witness. Dynegy alleges that Complainants fail to address forward price curves developed by its own consultant. Dynegy argues that the price forecasts were higher than the market-based forward price curves that existed at the time Dynegy negotiated its contract with CDWR.

Dynegy asserts that Complainants grossly overstate Dynegy's profit expectations. It notes that Complainants did not file any testimony, thus depriving Dynegy of an opportunity to engage in cross-examination or file rebuttal testimony. Dynegy argues that Complainants' figures of $635-$812 million in profits do not take into account taxes or other offsets, which would result in $387-$495 (accounting for taxes only). According to Dynegy, this amount is below its investment in its California units. Despite this result, Dynegy explains that it is "sound policy for generators to earn profits when the market is tight, enabling them to ride out the lean periods when capacity is plentiful."

v. El Paso

El Paso argues that Complainants failed to show any evidence that supports their contention that El Paso's prices were above market. El Paso states that its evidence proves that contract prices with CDWR reflect market prices with no indication of market dysfunction.

El Paso contends that the fact that agreed upon price was below current spot market prices and near-term forward prices but above long-term prices predicted at the time does not indicate that El Paso's price included expectations of continued dysfunction, as suggested by Complainants. El Paso argues that what Complainants describe as market dysfunction is nothing more than evidence of arbitrage in a competitive market.

According to El Paso there is no evidence in the record that supports Complainants' claim that El Paso's forward curves were above market. Rather than prove the point, El Paso charges that Complainants improperly assume that a dysfunctionality premium is imbedded in market and contract prices.

vi. Morgan Stanley

Morgan Stanley argues that Complainants have failed to meet their heavy burden to demonstrate generally that the bilateral forward contracts between the sellers and the CDWR were adversely affected by dysfunctions in the California spot markets. Specifically, Morgan Stanley states that Complainants have not and can not demonstrate that the Morgan Stanley Agreement contains a dysfunction premium.

Morgan Stanley points out that the record fails to demonstrate that dysfunctions in the California spot markets, when exacerbated by conditions of true supply scarcity, necessarily created conditions conducive to the withholding of power that pumped up the prices in the California spot markets. They state that such an assumption ignores the Commission's December 15, 2000 Order which specifically addressed the dysfunctions it believed were affecting the California organized spot markets (*e.g.*, the buy-sell requirement). Morgan Stanley avers that, regardless of whether power was withheld from California, Complainants have failed to demonstrate, and their expert witnesses did not provide any analysis of, a nexus between the California spot markets and the bilateral power markets in the West.

Morgan Stanley notes that its expert witnesses did analyze the relationship between these markets and testified that the pattern of prices in the bilateral spot markets at NP 15 and SP 15 was significantly different than the pattern of prices in the California spot markets. They also testified that the dysfunctions that the Commission identified in its December 15, 2000 Order as extant in the California spot markets were not present in the bilateral spot markets. Further, Morgan Stanley argue that the "evidence" that Complainants do cite, the two-week price collapse theory and the GE MAPS model results disprove, rather than prove the existence of a dysfunction premium. Morgan Stanley argues the two-week price collapse theory demonstrates that: (1) changes in market fundamentals do account for the decline in the forward power price during the period between May 24, 2001 and June 6, 2001; and (2) the PJM market either was adversely affected by the same dysfunctions

extant in the California spot markets or the PJM market suffered from the same type of dysfunctions. Morgan Stanley claims that Complainants confused, misconstrued, and misused GE MAPS model results so that they would support their theory of the case. However, it notes that when viewed appropriately the GE MAPS model results serve as an extremely conservative estimate of the absolute floor for what prices would have been.

Morgan Stanley states that the factual and empirical record evidence that Morgan Stanley and the other Respondents presented in this proceeding demonstrates that market fundamentals affecting supply and demand were the primary driver of forward prices rather than dysfunctions in the California organized spot markets and that on this basis alone the Commission should find that the Morgan Stanley contract meets the "public interest" standard.

Morgan Stanley contends that Complainants' summation of the evidence against Morgan Stanley in Appendix A6 demonstrates that the Morgan Stanley Agreement price was consistent with the forward market price when the contract was executed. Morgan Stanley states that the entire point of Complainants' exercise in Appendix A6 was to show that the "dysfunctionality premium" was embedded in the Morgan Stanley forward curve. It argues, however, that the "dysfunctionality premium" is not supported by the evidence. Morgan Stanley asserts that Complainants' allegation that Morgan Stanley received a $60 million dysfunctionality premium completely ignores the record evidence. For example, Morgan Stanley points to the Morgan Stanley Trader who derived Morgan Stanley's forward curve and

priced the contract and testified that Morgan Stanley did not include any premium for the alleged dysfunctional market. Morgan Stanley notes that it also offered evidence that it had no generation capacity to serve the contract and purchased power in the same markets as CDWR, and, as a result, Morgan Stanley was subject to the same prices and price risk as CDWR. Thus, Morgan Stanley concludes that Appendix A6 shows only that Morgan Stanley seeks to operate its business in a profitable manner and does so by offering power at market prices, neither of which is contrary to the public interest.

Morgan Stanley also argues that Complainants attempt to lump Morgan Stanley's contract along with other Respondents' contracts through unsupported assumptions, general conjecture and improperly attempting to shift the burden of proof onto Morgan Stanley. Morgan Stanley states that Complainants attempt to shift the burden of proof onto Respondents on two central issues: (1) Complainants "ask the Commission to *presume* that each contract, on the date it was signed, were [sic] hugely profitable . . . far exceeding any legitimate costs;" and (2) Complainants argue that "[t]he Respondents *have not explained*, nor can they, why a purchaser with superior leverage would (1) pay more, not less, than the sellers' forward price curves, (2) enter into contracts for 10 years, when it really wanted 1-3 year deals, and (3) agree to purchase large amounts of energy in the out years of the contract with relatively small amounts delivered in the early years when the purchaser desperately needed the power."

vii. Mirant

Mirant argues that Complainants did not demonstrate that the Mirant Agreement price was above Mirant's internal forward curve. Mirant states that, although Complainants purport to rely on Mirant witness' calculation of a levelized price from Mirant's forward price curves, it fails to mention some explicit caveats noted by the witness in presenting his calculations. First, Mirant notes that the witness explained that his calculation of a levelized price was based upon Mirant's historical forward curves for "mid" prices while Mirant's actual offer price for the CDWR (or any other) sale would have been developed using the ask price curve, which is by definition higher than the mid curve. Second, Mirant notes that the witness explained that the forward price curve he used reflected prices for trades of relatively small blocks of power, usually 25 to 50 MW, while Mirant committed to sell CDWR a 500 MW block of power. Mirant argues that the sale of such a large block would tend to command a higher price because as the witness testified "larger sales would be expected to move the market." Thus, Mirant notes that both of these factors tend to depress the forward curve-based price calculation.

Mirant also argues that Complainants failed to mention that forward prices climbed considerably between May 17, 2001, when Mirant and CDWR reached agreement as to basic terms of the Mirant Agreement, and May 22, 2001, when the parties executed the contract. Further, Mirant notes that, according to Complainants' expert witness, the May 22 date is the more appropriate date for purposes of

comparison since "either party could walk away from a contract until the contract was finalized."

Mirant states that the only analysis in the record of expected competitive prices as of mid- May 2001 demonstrates that the Mirant Agreement was not adversely affected by spot market dysfunction. It contends that Complainants failed to acknowledge that the GE MAPS modeling analysis relies on market information as of March 1, 2001 only, more than two months before the Mirant Agreement was negotiated.

ix. Sempra

Sempra contends that Complainants provided little, if any, record evidence directly addressing the Sempra Agreement. Sempra argues that the State provides no probative evidence demonstrating that the dysfunctional ISO spot markets adversely affected the rates, terms or conditions in the Sempra Agreement. Sempra argues that the State mischaracterized and misused the GE MAPS price forecast model, which did not and cannot model all relevant market fundament in particular, scarcity rents. Sempra contends that, in its initial brief, it demonstrated that this March 1, 2001 price forecast provides no probative evidence concerning the existence or magnitude of a dysfunction premium after March 1, 2001, when the Sempra Agreement was largely negotiated and finally executed. Sempra argues that this analysis was based on information regarding market fundamentals and forward price curves available more than two months prior to the execution of the Sempra Agreement and the expert nor Complainants ever attempted to calculate a dysfunction premium in a similar manner for any period after March 1,2001. Sempra concludes

that it is clear that Complainants failed to demonstrate the existence of a dysfunction premium in forward prices at any point after March 1, 2001, much less on May 4, 2001 (the day on which the Sempra Agreement was executed).

Sempra claims that Sellers' witnesses testified that a version of this unadjusted fundamental price forecast for on-peak prices prepared by Navigant in May 2001 (the month during which the Sempra Agreement was executed) showed that forecasted prices were significantly above forward prices for October 2001 through the 2005 calendar year, while they were below forward prices only during the summer of 2001. Sempra asserts that compared to the Navigant price forecast, which is more probative of CDWR's market expectations in the spring of 2001 than the interpretation of the after-the-fact GE MAPS results, the prices in the Sempra Agreement did not contain a dysfunction premium.

Sempra states that it did not rely on publicly available forward price curves in developing offer prices for the vast majority of its deliveries. Sempra asserts that Sempra considered a variety of factors other than forward price curves for electricity when pricing its bid to CDWR. Sempra also points to statements by California representatives indicating that CDWR was looking for prices in the $50-$60 per MWH range which became the starting point for Sempra's calculations of its offer prices. Sempra claims that it was hoping to develop a fleet of generation facilities in and around California that would be supported by the Sempra Agreement and that could be used to hedge Sempra's sales to CDWR. Accordingly, Sempra asserts that its offer price took

into account the substantial costs and risks associated with its generation development, while also factoring into its offer price certain costs and risks associated with contractual terms demanded by CDWR. Sempra argues that it only looked to forward price curves for electricity for the first two years of the term of the Sempra Agreement (during which time only 3 percent of the total power provided to CDWR under the Agreement would be delivered); however, Sempra had to look at forward price curves for power for these first two years because Sempra was aware that it would be acting as a purchaser during that time. Sempra argues that Complainants acknowledge that Sempra only looked at forward price curves to price "near term forward energy."

Sempra argues that, even assuming arguendo, that the Commission had found market power to be an issue relevant to this proceeding, the evidence shows that Sempra did not possess market power at the time of the negotiation and execution of the Sempra Agreement. Sempra contends that there is no procedural or substantive basis for applying the presumptions on market power issues that Complainants request. Sempra states that Sempra did not obtain authority from the Commission to make sales at market-based rates until April 10, 2001 and that Sempra did not have any power available for sale in 2001. Thus, Sempra argues that it was not "on the spot market" until CDWR made it clear that summer 2001 sales at below-market rates were a precondition to Sempra obtaining a long-term deal with CDWR and Sempra was forced to go out into the spot market as a purchaser to procure power to resell to CDWR. Sempra states that it could not have played any part in the "meltdown of the spot market" which occurred

in 2000 and early 2001. Second, Sempra states that the record also shows that there is simply no reason to presume that Sempra expected market power (or any other factor) to keep spot prices high because Sempra expected that spot prices would fall as a result of market fundamentals by 2002. Finally, Sempra contends that the record evidence demonstrates that there is no basis to presume that the rates under the Sempra Agreement reflect the expected future exercise of market power by Sempra or anyone else because, as a general matter, Complainants' own evidence demonstrates that the prices under the Sellers' contracts do not exceed long-run competitive prices.

x. Universal

Universal argues it has shown that the dysfunctions in the California spot market affected long term pricing and that market forces were not acting as a regulatory constraint. It argues that market-based rates must be in the same "zone of reasonableness" as cost-based rates. Universal argues that almost $600,000,000 a year in overcharges is evidence of unjust and unreasonable rates that should be investigated.

Universal questions what constitutes the "zone of reasonableness" as well as how this zone is to be derived in a market-based environment. Universal claims that Sellers did not provide data to show that Sellers' rates fell within a zone of reasonableness. Therefore, Universal avers that failure to provide this data is conclusive that the rates were unjust and unreasonable. Universal also argues that it has shown that prices under Sellers contracts were so scattered and so great "that no claim could be made that market

forces were keeping prices within the zone of reasonableness." Universal concludes that it has successfully shown that the rates in question are unjust and unreasonable and that the Commission must act on this showing or violate the FPA.

2. Benchmark Analyses

a. Initial Briefs

i. Complainants

Complainants allege that the Commission's $74/MWh benchmark requires adjustments to be useful in evaluating the contracts. They contend that the prices in the Allegheny, Coral, El Paso and Morgan Stanley contracts significantly exceed the benchmark even when $74/MWh is used as the benchmark for the first five years.

Complainants claim that the fact that the contracts incorporate the expected results of the dysfunctional spot markets is enough to satisfy the "public interest" standard and move to the remedy phase of these proceedings. They argue that in the absence of the presumptive protection of workably competitive markets, the only other logical method to determine just and reasonable rates for these contracts, while ensuring that all legitimate costs and a reasonable return are recouped by Sellers, is to resort to the traditional cost-of-service approach. Complainants note that, due to the ALJ's ruling that precluded discovery of Respondents' costs, Complainants were unable to demonstrate the excesses embodied in the rates in question in comparison to the Respondents' costs. They state that

notwithstanding the limiting effects of this ruling, they developed two surrogate measures of the overcharges that demonstrate that the magnitude of the adverse effect of the spot market dysfunctions on the instant contracts is substantial. First, they assert that evidence establishes that the price in each of the contracts contain the dysfunctionality premiums embedded in the forward price curves for 2001 and 2002. Second, they restate that the Commission's benchmark provides additional corroboration of the magnitude of the adverse effect embedded in each of the contracts.

ii. Trial Staff

Trial Staff argues that the Commission's $74/MWH benchmark should not be adjusted as Complainants' witnesses suggest. Trial Staff discredits Complainants' witness who challenged the accuracy of the benchmark because he did not know precisely what was contained in the benchmark because the Western Power Trading Forum did not provide the actual derivation of the $67.45/MWh rate that was adopted by the Commission and, therefore, could not say with any degree of certainty that the rate did not incorporate a 10 percent rate reduction from pre-restructuring levels, as the Commission stated in its December 15, 2001 order, or that the rate did not account for the value of ancillary costs included in pre-restructuring retail rates.

Trial Staff contends that to the extent a contract price fell below $74/MWh it should be considered just and reasonable. Trial Staff notes that the Governor had requested that the CPUC develop a benchmark and that Complainants' witness could not explain why it would not be reasonable to assume that the

$70/MWh target sought and achieved in the CDWR's portfolio was the benchmark. Trial Staff points out that the $70/MWh price target which CDWR achieved for its entire portfolio of long-term contracts was approved for pass-through by the CPUC. Additionally, Trial Staff asserts that the witness' valuation of the costs of ancillary services is overstated and based upon erroneous assumptions. Trial Staff claims that the witness' contention that the level of the benchmark was influenced by natural gas prices tainted by market abuse is without merit because no evidence was presented that market abuse occurred prior to the restructuring of the electric industry in California and it is unclear how historic embedded costs could be influenced by natural gas prices tainted by market abuse. Trial Staff points out that, under the witness' assertion that the benchmark reflects the historic costs of a portfolio of assets and therefore can only be meaningfully compared to a whole portfolio of contracts that serve an entire load profile, CDWR's portfolio of long-term contracts which is below the $74/MWh benchmark would be found just and reasonable. Trial Staff claims that, in arguing that the benchmark had to be translated into product-specific benchmarks to be a meaningful standard for comparison with contracts at issue, Complainants' witness erroneously assumed that the $74/MWh price was not comparable to the price for a 24-by-7 contract that offers power at a flat level throughout the day and year. Trial Staff also asserts that, in deriving their product specific benchmarks, Complainants' witness also erroneously used a cost ratio based on 1997 embedded costs, notwithstanding the fact that the $74/MWh benchmark was based upon 1996 costs. Trial Staff concludes that based upon these erroneous assumptions Complainants' witness concluded that the

prices in the Allegheny, Coral, El Paso, Morgan Stanley were above what they would have been if it had not been for the dysfunctional spot market.

Trial Staff does not believe that it is necessary to make any adjustment to the $74/MWh benchmark for the difference in the duration of the contracts and contract prices below the benchmark should be deemed just and reasonable. Trial Staff argues that the three methods of adjustment proposed by Complainants' witnesses are flawed and should not be used. Trial Staff asserts that the Sempra contract is below the benchmark because it provides an average rate below $70/MWh, with power provided during the summer of 2001 at below-market rates. Trial Staff states that the other contracts are more difficult to compare because they are above the $74/MWh benchmark and sets forth the difficulties in the comparison for the Dynegy, El Paso and Morgan Stanley contract.

Trial Staff argues that CDWR was unable to demonstrate any significant adverse affects that these contracts would have on either the California economy or the wholesale and/or retail customers. Trial Staff emphasizes that Complainants' witness' conclusion that the instant contracts had macroeconomic impact on the California economy because of overcharges associated with the contracts was discredited when the Respondents' witnesses pointed out errors in the analysis and Complainants' witness concluded that, after correction, his analysis would not show that the contracts were priced above long-run competitive prices.

iii. Sellers

Sellers argue that Complainants have failed to show any viable quantification of the magnitude of the alleged impact of the dysfunctional ISO spot markets on the contracts at issue. Sellers note that Complainants only attempt to quantify this alleged impact was through the direct testimony of an expert which was flawed and when corrected suggested that the contracts were not adversely affected by the dysfunction because they did not exceed long-run competitive prices derived from estimates of long-run marginal costs. Sellers also argue that Complainants' downward adjustment version of the Commission's $74/MWh benchmark ignores the plain meaning of the Commission's order establishing that benchmark and has no credible justification. Finally, Sellers contest Complainants' experts misuse of the GE MAPS Modeling Data developed by Sellers' witness.

viii. Allegheny

Allegheny points out that its contract price of $61/MWh and $76/MWh (for peaking power) are well below the Commission's benchmark price of $74/MWh for round-the-clock power. Allegheny states that it relied upon the Commission's benchmark in its negotiations with CDWR. It notes that its agreement is below numerous other benchmarks as well, including CDWR's target price of $70/MWh for long-term contracts. It contends that because the Allegheny contract was priced at $61/MWh it gave the State the leeway to enter into higher priced contracts while not causing the average price to exceed the $70/MWh target. It states that its Offer of Proof demonstrates that Allegheny's March 23, 2001, 11-

year, long-term power contract was comparably priced to post-June 19, 2001 contracts and that its April 2001 short-term peaking power contract for power in 2003 was similarly priced even below post-June 19, 2001 contracts that contained similar terms and conditions.

v. Coral

Coral argues that the price of energy in the Coral Agreement when levelized over the life of the contract falls below the Commission's just and reasonable benchmark of $74/MWH. Coral contends that in formulating an adjusted benchmark Complainants' witnesses ignored most of the distinguishing characteristics of the Coral Agreement: its substantial seasonal shaping, the value to CDWR of 500 hours per year of dispatch control over the Wildflower Units, and the agreement becomes a tolling structure in 2006 through 2011. Coral claims that segmentation of the eleven-year contract term into two periods, a five-year term and a six-year term, in the adjusted formula does not produce a valid economic benchmark. It contends that the composite benchmark is equally illogical and produces a "heads-I-win-tails-you-lose" result for CDWR.

Coral claims that the prices in the Coral Agreement when levelized over the term of the contract fall below the long-run marginal cost of generation in California as measured by Complainants' own witness.

vi. Dynegy

Dynegy states that quantitative evidence demonstrates that the price in the Dynegy Agreement

was driven by market fundamentals and did not exhibit any material influence of spot market dysfunction. Dynegy claims that its price is below Complainants' forward curves used by Navigant Consulting during the negotiation of the long-term contracts as well as the average forward prices reflected in contemporaneous broker sheets.

Dynegy responds to Complainants' arguments regarding the analysis of GE Maps by noting that Complainants' witness testified that a $6/MWh capacity charge would fully compensate generators fo their fixed costs, thus, withdrawing criticism of a capacity adder and advocating a higher charge than that used by one of Sellers' experts. It also counters that Complainants' witnesses provide the elements needed to disprove Complainants unfounded reliance on Sellers' expert's GE MAPS results.

vii. Morgan Stanley

Morgan Stanley contends that the long-run marginal cost of new generation is not relevant to the Morgan Stanley Agreement because, as a power marketer and price taker, Morgan Stanley's marginal cost of supplying power to CDWR is the offer side of Morgan Stanley's forward electricity price curve when the CDWR transaction was executed, not the long-run marginal cost of new generation. It asserts that the forward price curves produced by Navigant for CDWR are equal to, or higher than, the forward price curves that Morgan Stanley used to price its contract with CDWR.

Morgan Stanley claims that the Commission's $74/MWh benchmark does not apply to the Morgan

Stanley Agreement because: (1) CDWR did not consider the benchmark when pricing the contract, (2) Morgan Stanley relied on forward market prices, not the benchmark, to determine a reasonable contract price, (3) the Commission did not intend for the benchmark to apply to a single contract, and (4) the Commission did not intend to establish a cost-based standard for market-based prices for long-term contracts. It adds that the adjustments to this benchmark appear to be an impermissible collateral attack on the Commission's December 15, 2001 Order.

viii. Sempra

Sempra argues that Complainants have failed to provide any evidence specifically addressing the Sempra Agreement. It claims that the rates, terms and conditions of its contract are, and were acknowledge by CDWR and California officials to be, just and reasonable. It points out that the rates under the Sempra Agreement are just and reasonable when compared to the benchmarks used by Complainants, including an analysis of long-run competitive prices prepared by Complainants' witness.

b. Reply Briefs

i. Complainants

Complainants charge that Respondents have failed to explain the disparity between the forward prices and Dynegy's witness' fundamentals forecast. They state that Dynegy's witness did not claim, as Respondents state, that the disparity was due to scarcity rent, but rather could be explained by risk premium. They argue that their witness' testimony

supports Dynegy's witness' analysis and use of capacity adders and Respondents' attempt to change the record should be unsuccessful.

Complainants argue that Dynegy's revised fundamentals forecast prices are false due to misleading ranges and use of a weighted average calculation. Complainants contend that even using Dynegy's adjustments, the 2003 fundamentals forecast is below the forward prices for almost every month. Complainants assert that, despite the inaccuracies of the recalculation by Dynegy, there is still a significant price gap that can only be explained as a dysfunction premium, not a scarcity rent.

Complainants aver that due to the huge disparities between the benchmark contract of $74/MWH and Respondents' prices, which are substantially higher, they have made a compelling showing that a Phase II proceeding is warranted. The benchmark evidence raises a strong presumption that some sellers were exercising market power, thereby raising a similar presumption that the markets were not competitive. Furthermore, Complainants argue that the benchmark was ambiguous and subject to refinement therefore Respondents have no "reliance interest" in their interpretation of the benchmark. Additionally Complainants argue that any contracts exceeding five years should be compared to a benchmark that is extended on the basis of the Respondents' forward curves to ensure competitive prices. For any years beyond the first five, a benchmark of $74/MWH is not competitive, and should not be considered just and reasonable as Trial Staff argues.

Complainants assert that the benchmark applies to all sellers including power marketers based on underlying policy and prior Commission statements. While Morgan Stanley argues that the Commission did not intend for the benchmark to apply to power marketers, Complainants argue that at no point did the Commission imply that the benchmark only applied to suppliers owning existing generation equipment, nor did it exempt the contracts of power marketers when these issues were set for hearing. Additionally, applying the benchmark to power marketers is consistent with Commission policy objectives to contain prices. If the benchmark did not apply to power marketers in addition to other suppliers, generation owners would instead be insulated from the effects of the benchmark.

ii. Trial Staff

Trial Staff argues that Complainants presented flawed arguments concerning the application of the Commission's $74/MWH benchmark to the contested contracts. Trial Staff asserts that, with respect to the contract-specific benchmark analyses presented by Complainants, Trial Staff does not believe that reference to the Commission's benchmark demonstrates that the rates in these contracts were adversely affected by the spot market dysfunctions. Trial Staff argues that the rates in these contracts merely reflect the parties' expectations regarding future spot market prices, and, as discussed in Trial Staff's Initial Brief, there has been no showing that those expected future spot market prices were driven by anything other than market fundamentals. Moreover, Trial Staff states that a number of the contracts fully satisfy the Commission's benchmark.

For example, Trial Staff points to one of Allegheny's contracts, an 11-year contract priced at $61/MWh providing both around-the-clock (7-by-24) and peaking power, that is well below the $74/MWH benchmark and should on that basis alone be deemed just and reasonable.

Trial Staff contest Complainants' contention that, notwithstanding the fact that no benchmark analysis was done on the Dynegy, Mirant and Sempra contracts, "it is fair to conclude that the prices in these contracts also exceed the benchmark." Trial Staff argues that such a conclusion must be rejected not only because it is completely unsupported and speculative but also because it erroneously places the ultimate burden of persuasion on the Respondents, contrary to law.

iii. Allegheny

Allegheny contests Complainants' contention that the Commission should use the Dynegy Agreement to "help put in perspective just how extraordinary these agreements are." Allegheny states that there is no basis for the Commission to adopt this one-size-fits-all approach to characterizing the contracts at issue in this proceeding because the Allegheny Agreement and circumstances in which it was negotiated were distinct from the Dynegy Agreement. For example, it notes that the Dynegy Agreement involves sales from a group of generating facilities that Dynegy purchased while Allegheny owns no plants. It points out that Complainants allege that they entered into the Dynegy Agreement because they "desperately needed the energy Dynegy was offering for the summer of 2001" while, because Allegheny

owned or controlled no generation in the market, its entry into the market did not impact the quantity of supply available to the CDWR. It asserts that CDWR wanted to shift to Allegheny the costs and risks of purchasing at high prices and "borrow" money by using Allegheny effectively as a bank. Allegheny states that other differences with the Dynegy Agreement include the fact that (1) Allegheny's long-term contract with CDWR exceeds ten years, while the Dynegy contract is much shorter with a duration of three years, and (2) unlike Dynegy which structured a portion of its contract as a tolling arrangement with CDWR taking fuel risk, Allegheny assumed the full risk of fluctuating prices of natural gas in its contract.

Allegheny argues that the comparison to the Commission's $74/MWH benchmark shows that the Allegheny Agreement is *per se* just and reasonable, rather than that the Allegheny Agreement was affected by dysfunction. Allegheny challenges Complainants' contention that Allegheny's $61/MWh Agreement exceeds the benchmark even when $74/MWh is used for the first five years. Allegheny asserts that Complainants neglect to mention that the benchmark upon which these results are based is the "use the seller's forward curves" method for the period beyond five years which Trial Staff and Sellers' expert witnesses thoroughly discredited. Allegheny states that the figures cited by Complainants as the amounts by which the Allegheny Agreement "exceed the benchmark" are therefore meaningless and incorrect and that Complainants claim that these figures evidence effects of the dysfunctional spot market on forward markets is merit-less. Further, Allegheny claims that Complainants' contention is surprising

since their own pre-filed testimony shows, as confirmed by Dr. Pechman on cross-examination, that the first five years of the Allegheny $61/MWH rate is not only substantially lower than the Commission's $74/MWH benchmark but also lower than the lowest version of Complainants' "retooled" price adjusted and product-specific adjusted benchmark of $61.50. It notes that Trial Staff agrees that the Allegheny Agreement satisfies the Commission's $74/MWH benchmark. Thus, Allegheny believes that the comparison of the primary Allegheny Agreement, at $61/MWH, to Complainants' own projections of non-dysfunctional prices shows that the Allegheny Agreements produce significant savings, as opposed to overcharges or "dysfunction premiums," as compared to the Commission's benchmark.

iv. El Paso

El Paso asserts that Complainants cannot adequately compare the El Paso Agreement with the $74/MWh benchmark. It contends that comparing the two ignores the extrinsic factors that justify the terms of the contract. El Paso argues that Complainants ignored the specific guidance of the Commission as to the legal effect of the benchmark: anything below the benchmark is just and reasonable. El Paso also argues that, in *San Diego Gas & Elec.*,[155] the Commission stated that buyers may elect to enter into contracts above the level of the benchmark provided the contract suits their needs. Based on this holding, El Paso avers that there is no justification for using the $74 benchmark. Even if the benchmark was a starting

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[155] San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, 93 F.E.R.C. ¶ 61,294 at 61,995 (2000).

point used to measure the reasonableness of the El Paso Agreement, El Paso argues that it provided values other than price to CDWR, such as bearing additional default risk than is standard in order to assist California during its power crisis. El Paso contends that these additional non-price values should be taken into consideration as well.

v. Mirant

Mirant asserts that Complainants' request for an affirmative finding that the challenged contracts were adversely affected by dysfunction in the ISO spot markets by comparing four of those contracts to the Commission's $74/MWH advisory benchmark should be rejected. Mirant contests Complainants' argument that "margins by which these four contracts exceed the relevant benchmarks are so wide that it is only proper to conclude that the remaining contracts, Dynegy, Mirant and Sempra . . . must also exceed the benchmark by some margin," noting that Complainants ask the Commission to presume that the Mirant Agreement would not compare favorably with the Commission's benchmark, if such an analysis were (or could be) done, and that contract modification is warranted as a result. Mirant notes that Complainants' expert witnesses never applied the benchmark to the Mirant Agreement. Mirant states that Complainants' expert conceded at hearing that

comparison could establish that link, they should have provided that comparison as part of their affirmative case.

Mirant notes that it undertook its own benchmark analysis as part of its direct case. Mirant's expert witness compared the Mirant Agreement to three other CDWR power purchase agreements and found that the price in the Mirant Agreement was comparable to the prices in those contracts. Although Mirant's expert's testimony was stricken, Mirant points out that the ALJ allowed Mirant to submit the stricken testimony as an offer of proof. Mirant argues that, if the Commission agrees with Mirant that its expert's benchmark comparison should be taken into account, the case against modification of Mirant's Agreement becomes clearer because the analysis further demonstrates that the Mirant Agreement was not adversely affected in any manner by dysfunctions in the ISO spot markets. Mirant states that regardless of whether the Commission considers its expert's alternative benchmark analysis, it must disregard Complainants' assertion that the Commission should assume that the Mirant Agreement would fail any such benchmark comparison because Complainants' tactic is improper and is a request for a presumption based upon analyses that were never done.

vi. Morgan Stanley

Morgan Stanley states that the difference between the $74/MWH benchmark and the Morgan Stanley contract price does not prove that Morgan Stanley included a dysfunctionality premium in the contract price.

vii. Sempra

Sempra states that the Sempra Agreement compare favorably to a variety of benchmarks. Sempra points out that while Complainants' witnesses decided against conducting an analysis of the Sempra Agreement, Sempra submitted a different kind of "benchmark" analysis in Sempra's direct case. Sempra states that its witness compared the rates in the Sempra Agreement against 14 long-term contracts that CDWR entered into after June 19, 2001 (when no party alleges that ISO spot markets were dysfunctional) and found the prices in the Sempra Agreement to be comparable, or in a number of instances, superior to prices in these 14 long-term contracts executed after June 19, 2001. As a result, its witness concluded that the Sempra Agreement was free from spot market dysfunctions. Sempra contends that, to the extent the Commission agrees to accept Sempra's Offer of Proof, it provides another piece of evidence showing that the Sempra Agreement should not be subject to abrogation or modification.

3. Relative Bargaining Power

a. Initial Briefs

i. Complainants

Complainants assert that the number of bids received in response to the RFBs is insignificant because all of the negotiations occurred above the inflated forward price curves.

They claim that Respondents' contention that CDWR had options is further undercut because (1)

many of the bids were for less than 100 Mws when CDWR needed 12,000-15,000 Mws, (2) many of the offers started delivery after the summer of 2001, and (3) many of the sellers were unknown entities without experience in the power industry.

Complainants argue that, under the extraordinary circumstances in which CDWR was purchasing power, CDWR had essentially no bargaining power. They assert that Respondents have not explained and cannot explain why a purchaser with superior leverage would (1) pay more, not less, than the sellers' forward price curves, (2) enter into contracts for 10 years when it needed 1-3 year contracts, and (3) agree to purchase large amounts of energy in the out years of the contracts with relatively small amounts delivered in the early years when the purchaser desperately needed the power.

ii. Trial Staff

Trial Staff argues that the totality of purchases and the conditions present at the time the contracts were entered into do not justify contract modification. Trial Staff contends that CDWR, through the California Energy Resources Scheduling Division (CERS), procured a diversified portfolio of contracts which varied in terms of the products provided and length of the contract with a variety of suppliers and power companies at an average contract price over the May 2001 through December 2010 period below the $74/MWh benchmark established by the Commission. Trial Staff claims that the terms and conditions of the proposals made by CDWR and the processes and procedures CDWR used to evaluate the contracts were the result of decisions freely made by CDWR. Trial

Staff asserts that CDWR's purchasing strategy was intended to, and did, shift considerable risk to the sellers such as the risk of rising natural gas costs and the lack of payment assurances. Trial Staff also contends that CDWR sought "a weighted average cost of long-term contract energy expected to be within the combined average cost of energy supply reflected in the IOU's retail rates, as of January 2001." Trial Staff notes that CDWR's purchasing strategy later changed when it became willing to accept "tolling" agreements. Trial Staff asserts that CDWR's primary goal was to achieve a diversity of supply sufficient to cover the net short for the summer of 2001 at an average price not to exceed the $70/MWh benchmark established by those in charge of the negotiations with the objective of depriving the spot market of its volume and thus taming its out-of-control prices.

Trial Staff concludes that CDWR mostly succeeded in meeting its objectives: (1) forming a portfolio of short, intermediate and long-term contracts covering a variety of energy products (*e.g.*, 24-by-7 or baseload supply and 6-by-16 peaking service) at an average price that fell below the $70/MWh benchmark it had set and (2) stabilizing the market by entering into long-term contracts. Trial Staff claims that CDWR did not have a formal process in place for reviewing or evaluating the contracts until mid-March 2001 which led to ill-advised decisions or choices. Trial Staff concludes that CDWR's RFBs and its purchasing strategies were the reason that CDWR may have purchased supply under contracts with longer terms than it would have liked. Trial Staff notes that CDWR issued RFBs in which the entire risk of the rising cost of gas was placed on the sellers, the sellers had no assurance that CDWR would meet its

financial obligations and CDWR set its pricing goals significantly below the current market prices.

Trial Staff contends that, given the number of parties who were interested in selling power to the State of California on a long-term basis, CDWR had options and did not lack bargaining power due to the crisis that existed. Trial Staff argues that, in fact, it was the sellers who may have lacked alternatives, given the fact that CDWR was in essence "the sole purchaser" who controlled the information sellers had on the State's success in procuring adequate future supply. In response to CDWR's contention that these numbers are deceiving because many of the bids were less than 100 MW when CDWR needed 12,000-15,000 MW, many of the offers did not start deliveries until after the summer of 2001 and many of the sellers were unknown entities with no experience in the power industry, Trial Staff states that these arguments assume that the referenced sellers were the only ones with whom CDWR was negotiating while the evidence presented indicates otherwise.

In response to CDWR's contention that it was not "the only game in town" due to sellers profitable alternative of selling their power in the dysfunctional, high priced spot market and the circumstances under which it was purchasing (*i.e.*, continuing Stage 3 alerts and its inability to continue purchasing in the high priced spot market), Trial Staff notes that CDWR's witness admitted that CDWR was "essentially a single purchaser," with an enormous demand that was not elastic, CDWR did not expect the high prices in the spot market to last beyond a year or two at most and CDWR and sellers knew that once CDWR began to procure long-term supplies it would have an adverse

affect on the lucrative spot market. Trial Staff also notes that CDWR negotiated with sellers on an individual basis and controlled the information sellers had on its negotiations with other suppliers which affect sellers' ability to judge whether their offers would be accepted. Trial Staff notes that, even if CDWR lacked options or believed that it lacked options in these negotiations, sellers did not given that impression due to the situation and the press reports. Trial Staff also notes that, after executing the first few long-term contracts, CDWR gained negotiating leverage and could be more selective regarding prices and terms.

Trial Staff argues that contemporaneous statements made by CDWR and the Governor indicated that they fully supported the price, terms and conditions of these contracts at the time they were executed. Trial Staff notes that the CDWR witness who informed the public about CDWR's contracting efforts confirmed his press statement reported on April 20, 2001 that "[i]f the prices just get ridiculous altogether, there's a policy call to be made, and we'll cross that bridge when we get there."

Trial Staff provides a contract by contract review of the Dynegy, El Paso, Morgan Stanley and Sempra agreements to demonstrate that CDWR was not forced tc accept unreasonable rates, terms or conditions, but rather achieved its targeted objectives and willingly agreed to enter into these contracts.

iii. Sellers

Sellers state that the evidence demonstrates that CDWR established and achieved its long-term

contract objectives: (1) CDWR established and achieved the objective of obtaining power at a portfolio average price of $70/MWH; and (2) CDWR established and achieved non-price objectives.

iv. Allegheny

Allegheny argues that it entered into arm's-length negotiations in good faith with CDWR at the solicitation of CDWR. Allegheny states that the terms of the solicitation and the contract were largely dictated by CDWR.

Allegheny notes that, by the time CDWR signed its contract with Allegheny late in the process, long-term agreements had been reached by CDWR with over 30 parties for more than 8,000 MW and CDWR had reached its goal of contracting for fifty percent of the "net short." Allegheny asserts that, by that time, CDWR was negotiating contract terms and conditions that were more beneficial to CDWR than the prior contracts.

Allegheny contends that it had little bargaining power because it sought to enter into a long-term contract in the western markets. Allegheny claims that CDWR made several key demands on Allegheny as a precondition to entering into a contract, including: (1) Allegheny would commence service beginning in March 2001 through the summer 2001 peak periods; (2) Allegheny would back load the contract and sell peak power to the State at a subsidized rate of $61/MWh (when peak prices were approaching $450/MWh); and (3) Allegheny would assume all market exposure to changes in electricity and gas

prices. Allegheny states that it agreed to these conditions.

Allegheny asserts that CDWR asked Allegheny to commit to a performance obligation with CDWR, which Allegheny describes as essentially a shell entity without assets, cash or credit, and that CDWR would not provide any guarantees from the State or any other creditworthy entity for CDWR's performance obligations.

Allegheny contends that CDWR had substantial bargaining leverage with Allegheny by virtue of the hundreds of offers in response to it solicitations and thousands of megawatts more offered outside the solicitation process. It asserts that CDWR kept the terms of these offers from Allegheny and that CDWR used this information in negotiations as leverage against Allegheny. Allegheny argues that CDWR had ample bargaining power and numerous options as illustrated by CDWR's insistence upon numerous unconventional contract terms, including agreeing to sell at a substantial loss in the initial period of the contract, which Allegheny states it had to accept.

Allegheny states that the contract prices were strictly based upon then-prevailing forward curves, not the current spot prices. It contends that it assumed all exposure to changes in market prices which was significant.

Allegheny states that it was required to and in fact hedged its obligations under the contract, including purchasing power at a loss in the high spot markets to honor its contract obligations to CDWR. It adds that it also entered into a long-term tolling

arrangement in April 2001 at the height of the market dysfunctionality at a substantial cost to insure its performance for the entire contract term. Allegheny contends that both CDWR and Allegheny knew that Allegheny would be required to sell power to CDWR at a substantial loss in the early years, with the expectation that Allegheny would recoup such losses at the back-end of the contract. Allegheny states it incurred hundreds of millions of dollars in realized cash losses to date in honoring its obligations under the contract.

Allegheny asserts that CDWR set out to accomplish specific goals in procuring long-term power, including reducing its reliance on the spot market and providing a secure and reliable long-term source of supply. Allegheny states that it helped CDWR accomplish these goals.

v. Coral

Coral argues that Complainants failed to prosecute two of their three complaints against the Coral Agreement. It notes that Complainants had alleged that three provisions were unjust and unreasonable and thus should be abrogated or modified: (1) sec. 10.2(b) which subordinates CDWR's bond obligation to the payment to Coral for energy and capacity supplied to CDWR under the contract, (2) sec. 3.10 which provides Coral with most-favored-nations rights with regard to credit, security and payment priority and (3) sec. 3.6 which adopts the March 16, 2001 fixed prices, as modified May 25, 2001, by CDWR for energy deliveries from May 24, 2001 to December 31, 2005.

Coral responds that it was CDWR who proposed both the bond subordination and most-favored-nations provisions, and Complainants did not present any evidence demonstrating that these provisions were unreasonable. It notes that Complainants Coral-specific evidence focused entirely on the third disputed provision regarding price.

vi. Dynegy

Dynegy points out that Complainants did not discuss the particular terms of the Dynegy Agreement either in its direct or rebuttal case. Dynegy argues that the Dynegy Agreement was a mutually beneficial agreement sought by both parties. It contends that CDWR had the resources of the State behind it, was advised by consultants, had choices and wielded significant leverage during the negotiations. It states that the length of the Dynegy Agreement was not controversial during the negotiations. It notes that the Dynegy Agreement is not back-end loaded: the pricing provisions for the firm (fixed-price) and contingent (tolling agreement) power do not change over the life of the contract and Complainants benefit from the reduction in natural gas prices. It asserts that Complainants have no basis for complaining about the non-price provisions in the Dynegy Agreement.

vii. El Paso

El Paso contends that the El Paso Agreement arose out of an arms' length negotiation that required compromise on the part of each party to reach a mutually agreeable price term. El Paso states that, once CDWR indicated its unwillingness to enter into an agreement using standard industry credit

protections, El Paso acquiesced and agreed to include CDWR's proposed terms, including its proposed "most-favored nation" clause (Section 3.10). It adds that it acquiesced to additional terms, most of which constitute the clauses that Complainants request be abrogated on the ground that they reflected unequal bargaining positions of the respective parties. It argues that CDWR had a savvy, experienced negotiating team and numerous options. It states that there is no evidence that CDWR was not content with the negotiation or the agreement reached. It contends that, to the extent CDWR operated under any limitations in its bargaining posture and in its choice to contract with a particular party, those limitations were self-imposed. It claims that, if CDWR had not been limited by the State's retail rate objectives and had acted over a longer timetable, California would have been able to take advantage of declining prices. It argues that CDWR and its advisors realized that El Paso had treated CDWR fairly in connection with the two 50 MW purchases because CDWR chose to pursue a follow-on contract with El Paso. It notes that during the negotiations CDWR representatives and the Governor gave assurances to El Paso that CDWR and California would perform their end of the deal.

viii. Mirant

Mirant argues that the only evidence in the record on the specific circumstances of the Mirant Agreement shows that Mirant did not exert any undue leverage in entering into this contract.

ix. Morgan Stanley

Morgan Stanley argues that CDWR, not Morgan Stanley, had superior bargaining power in their contract negotiations.

x. Sempra

Sempra claims that the Sempra Agreement was the result of a lengthy negotiation process in which CDWR enjoyed significant bargaining power over Sempra and Sempra had few options available to it.

b. Reply Briefs

i. Complainants

Complainants argue that whether or not CDWR exercised or held bargaining leverage is not a factor to be considered in whether the resulting contracts are just and reasonable. They claim in any case that CDWR's contracts undermine any bargaining leverage argument as none of the contracts were priced below the forward curves. They assert also that Respondents had other options for power sales and it was their choice to remain in the spot market during a period of unprecedented pricing.

ii. Trial Staff

Trial Staff contends that Complainants did not show that the bids CDWR received for power supply reflected continued expectations of dysfunction in the spot markets. Trial Staff notes that, according to Complainants, the fact that CDWR had to accept contract terms that it was not content with supports

their claim that CDWR did not have superior leverage in the negotiations. However, Trial Staff argues that Complainants fail to mention that in order for CDWR to meet its purchasing objective of keeping the average price of its portfolio at or below $70/MWH, CDWR was going to have to accept longer term contracts with a levelized price, regardless of the leverage it may or may not have had at the bargaining table. Trial Staff argues that this price target combined with the fixed-price contracts CDWR was seeking had an impact on the type of offers that CDWR was receiving in response to its RFBs. Trial Staff notes that Complainants contend that the offers that CDWR received did not come close to the amount of energy needed to make it through the summer of 2001; in support, Complainants refer to Exhibit CAL-157 which reflects the bids CDWR received in response to the two RFBs. Trial Staff argues that Exhibit CAL-157 does not tell the real story because it does not include the offers CDWR was receiving from suppliers outside of the RFB process - offers that were for significant amounts of energy.

iii. Allegheny

Allegheny points out that Complainants have dropped the contention raised in its Complaint that the contracts contained "onerous," non-price terms which justified abrogating or modifying the contracts. It notes that Complainants concedes that these terms were "the product of negotiations" between the parties and that, "in some cases, CDWR was able to negotiate on material terms, including price." Allegheny asserts that, at hearing, Complainants elected not to put on a fact witness to contest Mr. Koenig's testimony that many of the key terms in the Allegheny contract,

including those relating to price and duration, were driven by the CDWR. Allegheny argues that this was not surprising given the numerous contracts rejected by CDWR on the basis of price, (including rejecting Allegheny's initial offers) and CDWR ability to impose "dealbreaker" ultimatums on Allegheny. Allegheny states that CDWR's abandonment of its claims with respect to non-price terms, coupled with Mr. Koenig's unrebutted testimony regarding price negotiations, compels a finding that Sellers did not have bargaining power over CDWR in the forward bilateral markets with respect to both price and non-price terms.

Allegheny states that Complainants misstate the record regarding CDWR's negotiating position with Allegheny and that the CDWR received valuable and significant megawatts from Allegheny in the front end of the contract and could have received more. First, it asserts that the Allegheny $61/MWh Agreement provides for 750 MW of 6x16 peaking power from April 1,2001 to June 30, 2001 and 250 MW of 6x16 peaking energy from July 1,2001 to September 30,2001 at a subsidized, fixed price despite tight supply conditions and the high volatility in the market. Second, Allegheny states that it made numerous offers in response to CDWR's RFBs, many of which CDWR rejected or changed to suit its needs.

Allegheny also argues that Complainants fail to address the evidence demonstrating that CDWR had ample bargaining power and achieved its objective. In response to Complainants' claims that the responses to the RFBs, which separately provided bids for approximately 13,000 and 16,000 MWs, respectively, would have given CDWR "at most about 5,000 MW under contract for the summer of 2001, about one third

of the projected peak net short energy demand," Allegheny argues that Complainants provide no evidence that CDWR did not or could not negotiate with the bidders about providing power in the summer of 2001 or earlier. Allegheny avers that CDWR used its considerable leverage to get Allegheny to supply peaking power in the spring and summer of 2001, after Allegheny proposed to provide power beginning in October 2001. Allegheny argues that Complainants assume that CDWR negotiated only with the sellers that provided further responses to the RFBs, but note that, to the contrary, CDWR's internal documents demonstrate that CDWR negotiated and contracted with many other sellers outside of the RFB process. Allegheny claims that not once in Complainants' Initial Brief do they mention that CDWR rejected at least 45 proposed contracts, involving thousands of megawatts, more than half of which were rejected because of the price terms. Allegheny asserts that rejection of these proposed contracts "came in various stages of negotiations" and that CDWR rejected some proposals "almost immediately on the initial price offering."

iv. Dynegy

Despite worries about the State's creditworthiness, Dynegy states that it entered into short-term contracts in an effort to assist the State with its energy crisis during on-going contract negotiations. Dynegy asserts that throughout these negotiations the State threatened to use the Governor's office as well as the media as leverage, backed out of deals, and demanded renegotiation.

Dynegy argues that the State's claim of uneven bargaining power is misplaced. According to Dynegy, the State uses an inaccurate profit estimate as proof that Dynegy had uneven bargaining power that Dynegy used to compel the State to accept prices that contained spot market dysfunction premiums. Dynegy responds that its contract helped the State meet important goals. Dynegy states that the Dynegy Agreement was for a short-term, the contract prices were under the forward curves at the time the contract was made, and the agreement did not backload capacity, instead making 1000 MW immediately available. Dynegy concludes that the State's complaints about contracts with Sellers do not apply to the Dynegy Agreement.

Dynegy contends that the State knew what it was bargaining for with Dynegy and obtained what it wanted through its negotiations with Dynegy. According to Dynegy, the result was short, medium and long-term contracts with an average price of $70/MWH. Dynegy asserts that the State was content with its bargain but now reaches a different conclusion.

v. El Paso

According to El Paso, testimony shows that prices were mutually agreed upon and were negotiated at arms' length.

vi. Mirant

Mirant asserts that Complainants have mischaracterized the facts in an effort to show undue bargaining strength on the part of Mirant. Mirant

states that when these distortions are eliminated and the context is understood, it is clear that Mirant did not have superior bargaining strength in its negotiations with CDWR, and, if anything, the evidence shows that CDWR may have had superior leverage given its status as the biggest (and virtually the only) creditworthy purchaser in California. Mirant states that, contrary to Complainants' position that Mirant was seeking to avoid a long-term deal and focus on alleged higher profits in the short-term market, Mirant actually refrained from making a shorter-term deal pending completion of its May negotiations with CDWR.

vii. Morgan Stanley

Morgan Stanley asserts that Complainants have not proven, and cannot prove, that Morgan Stanley exercised superior bargaining power in negotiating its contract with CDWR. It contends that the rate, terms and conditions in the contract reflect the outcome of arm's-length negotiation between sophisticated market participants and, if anything, the record evidence shows that CDWR, rather than Morgan Stanley, had the superior bargaining power in the contract negotiations.

viii. Sempra

Sempra asserts that CDWR had bargaining leverage over Sempra because CDWR was "the only game in town" for purposes of securing a long-term contract of the magnitude that could be used to support the significant amounts of generation that Sempra wished to develop in and around California, while CDWR had a broad variety of sellers willing to

make sales to it and had secured a large percentage of the power it wished to have under contract prior to the execution of the Sempra Agreement. Sempra also states that Trial Staff confirmed that, by the time the Sempra Agreement was executed, CDWR had significant bargaining power over potential suppliers and that as early as February 2001, a CDWR negotiator felt that CDWR had the ability to tell a potential supplier to "take a hike" and that it "only stands to reason that once CDWR executed the first few long-term contracts, it gained greater negotiating leverage and could be more selective as to what prices and terms it would accept."

Sempra contends that it made repeated concessions to CDWR throughout the negotiation process, including modifications to Sempra's initial bids that resulted in Sempra making sales to CDWR during the summer of 2001 at below-market rates, reducing the amounts of baseload energy that Sempra would provide to CDWR and taking on transmission risks that would ordinarily be allocated to the buyer. Sempra states that, although Complainants now claims that CDWR did not want large amounts of power in the later years, a review of Sempra's initial bids reveals that Sempra had offered CDWR the option of having Sempra provide smaller amounts of power, over a shorter period, than the parties eventually agreed to in the executed Sempra Agreement.

Sempra argues that, contrary to Complainants' claim that ISO spot market dysfunctions forced CDWR to enter into contracts with the Sellers, CDWR was under no obligation to enter into any long-term contracts in order to satisfy its obligations under California law, much less the ten plus year Sempra

Agreement, and, indeed, CDWR was not legally obligated to purchase power under contracts of any duration. Further, Sempra claims that the record evidence demonstrates that, even to the extent CDWR believed it was compelled to purchase power, its need was only for near-term purchases for the summer of 2001. Moreover, it contends that record evidence demonstrates that CDWR sought to enter into long-term contracts with market participants such as Sempra to encourage the entry of new generation, a goal separate and apart from any need to acquire near-term supplies.

4. Equities of Modification or Abrogation

a. Initial Briefs

i. Complainants

Complainants assert that contract reformation here would not impede the making of contracts in the normal course. They argue that sellers would know that, absent a declared market dysfunction which they would be aware of, their contracts would not be reformed. They state that, even in such circumstances, sellers would know that sellers would recover a healthy rate of return even if reformation were ordered. They contend that, if no remedy is available in these circumstances and another crisis occurs, the public would be loathe to enter into forward contracts for which no remedy would be available. They assert that the public would opt instead to stay in spot markets and seek refunds. They conclude that for these reasons the denial of a remedy here would

deter forward buying precisely when it is otherwise desirable.

ii. Trial Staff

Trial Staff notes that contract modification may have an adverse impact on the efficient operation of the power market, on investment in new generation and on the willingness of market participants to enter into long-term contracts in the future. Trial Staff points out that any increase in prices associated with the potential regulatory risk of abrogation or modification of contracts will eventually be borne by customers in the form of higher energy costs. Trial Staff argues that the issue of investor confidence is of utmost concern and that contract abrogation or modification should not be permitted, therefore, unless a sufficient showing has been made that such an extraordinary remedy is required given the adverse affect such action could have on investor confidence in the industry.

iii. Sellers

Sellers argue that Complainants have not shown that the contracts place an excessive burden on customers. Sellers argue that sound policy demands that the sanctity of these contracts be affirmed. Sellers request that the Commission discourage other states from pursuing California's restructuring initiatives. Sellers assert that the abrogation or modification of the contracts at issue will discourage forward contracting and defeat the solution that the Commission prescribed for California's energy crisis. Sellers point out that, if it grants the complaint, the

Commission will discourage needed investment in generation.

iv. Allegheny

Allegheny concludes that Complainants failed to meet their burden of proof that Allegheny's contract was contrary to the public interest or even that modification would be appropriate under the lower burden "just and reasonable" standard. It states that by contrast it has demonstrated that it would be substantially financially harmed if the agreement were abrogated. It argues that the Commission should not modify or abrogate the instant contracts but rather affirm the sanctity of the instant contracts.

v. Mirant

Mirant contends that Complainants have failed to provide evidence that would support abrogation or modification of the Mirant Agreement under the "public interest" standard. Mirant argues that Complainants have not shown that the challenged contracts impose any burden on customers, did not attempt to argue that the Mirant Agreement is contrary to the public interest based upon a comparison with the Commission's $74/MWh. Mirant asserts that Complainants have not offered any credible evidence to counter Mirant's testimony on the specific and immediate detrimental effects of contract abrogation, as demonstrated by the current statements and reports of ratings agencies.

vi. Morgan Stanley

Morgan Stanley argues that Complainants did not offer any evidence that the Morgan Stanley Agreement itself will impact CDWR's financial ability to continue service, constitutes an excessive burden on other CDWR wholesale customers, or is unduly discriminatory against other CDWR wholesale customers. It contends that the Morgan Stanley's Agreement to supply 50 MWh of forward wholesale power amounts to a mere fraction of the power CDWR contracted for to serve California during the relevant period and could not have any material impact on CDWR's financial ability to continue service, constitute an excessive burden on wholesale customers or unduly discriminate against wholesale customers.

Morgan Stanley argues that abrogation of the Morgan Stanley Agreement or substitution of the $74/MWh benchmark as requested by Complainants would cause Morgan Stanley significant losses. It states that, if the contract is modified, Morgan Stanley will be less willing to enter into forward wholesale electricity contracts in the future and prices in any such contract would include a risk premium to protect Morgan Stanley and its shareholders from increased regulatory risk. Additionally, it claims that such an action would not be in the public interest because it would not promote the Commission's goal of a viable competitive wholesale power market.

vii. Sempra

Sempra notes that the Sempra Agreement provides incentives for the construction of new generation which will directly benefit California and

its customers but places Sempra at risk because the generation is unlikely to be profitable under current spot market and current expected future spot market prices. Sempra states that abrogation of the Sempra Agreement would be disastrous for Sempra in terms of its ability to develop and construct new generation and may result in the company ceasing to exist.

b. Reply Briefs

i. Complainants

Complainants argue that they have shown that the public will bear unjust and unreasonable rates and that the public interest in competitive markets is threatened by allowing Respondents' exploitation of the spot market dysfunction in order to reap windfall profits in the forward markets. Complainants contend that the public should not have to bear the dysfunctional future spot market rates that the Commission has determined they should not bear for spot market purchases from October 2, 2000 through June 20, 2001 merely because the rates are embedded in long-term contract prices. Moreover, the public interest in restoring confidence in the electric industry and avoiding the creation of uneconomic demand-side incentives should outweigh the regulatory risk to the sellers. Complainants further argue that because the sellers' market-based rate authority is regulated by the Commission, sellers were aware of the likelihood that, once the market was no longer competitive, they would have to justify their contract rates.

Complainants state that contracts that are the product of arm's-length negotiation between discriminating buyers and sellers in a competitive

marketplace should naturally fall under the "sanctity of contracts" and be upheld. They assert, however, that such is not the case in the instant matter. Here, high forward contract prices for delivery of power greatly exceeded prices that would result from a normally functioning competitive future spot market. Thus, the public should not be burdened with rates based on expected noncompetitive market conditions. In response to Respondents' challenge that reforming the contracts could cause future buyers and sellers to determine that contracts are not safe from hindsight modification, Complainants answer that argument by suggesting that the Commission explicitly state the reasons for any contract modification that might take place in these circumstances, stating that regulatory risk through modification of power purchase agreements has always been part of the electricity market landscape.

Complainants contend that failing to reform these contracts under these extraordinary circumstances will create disincentives for future buyers to enter into forward contracts because they will lose the possibility of refunds for spot market purchases. They state that, if the contract prices reflect an expectation that the spot market dysfunctions would inflate prices over competitive levels for 2001, 2002 and 2003, then public policy dictates that the Commission alleviate the burden of those prices on the public.

ii. Sellers

Sellers argue that the State has wrongly attempted to use its own flawed policies on market restructuring as a reason for relieving the State of its

contractual obligations to Sellers. Sellers contend that modifying the CDWR contracts will signal that the Commission will protect states from their own mistakes, such as implementing fundamentally flawed restructuring plans, even to the extent of modifying freely negotiated commercial contracts. In short, Sellers maintain that the State should take responsibility for its own errors, especially regarding retail matters over which the Commission has little, if no, jurisdiction.

iii. Dynegy

Dynegy argues that to allow the contract to be rewritten would send a negative message to market participants who might refuse to negotiate the next time markets are tight.

iv. Sempra

Sempra also avers that the State fails to justify the abrogation or modification of the Sempra Agreement under either the *Mobile-Sierra* "public interest" standard or the "just and reasonable" standard. First, it contends that the State fails to provide any direct evidence showing the Sempra Agreement to be unjust and unreasonable and instead attempts to attack the Sempra Agreement based solely on flawed and invalid comparisons. It claims that Complainants do not provide accurate information on the Sempra Agreement because, for example, the price in the Sempra Agreement is linked to a gas index price for the period from June 1, 2003 through September 30, 2011, rather than through September 30, 2003, as Complainants claims. In addition, the price for power provided on a 6 x 16 basis under the Sempra

Agreement during the gas index price period is not "$3 l/MWH + (gas index x 10,500)" as Complainants represents. Thus, it argues that Complainants mistakes a key element of the pricing provisions of the Sempra Agreement: the heat rate for 6 x 16 power.

Sempra states that there is also no value in Complainants' comparison of the Sempra Agreement to the Dynegy and Coral Agreements. It notes that the Dynegy contract is a three and a half year contract under which Dynegy will supply power to CDWR from existing generation resources. In contrast, it points out that the Sempra Agreement has a term of more than ten years and is structured with the intent of allowing Sempra to develop and construct new generation sufficient to meet its delivery obligations under the Sempra Agreement. As for the Coral Agreement, it claims that Complainants' witnesses admitted that the Coral Agreement and the Sempra Agreement were dissimilar, and, in rebuttal testimony, they "evaluated the...Coral contract[], taking into account the peculiarities of product mix and contract duration" in order to contrast rates in the Coral Agreement to the Commission's $74/MWH benchmark." However, Sempra notes that the witnesses testified that they could not undertake a similar evaluation of the Sempra Agreement because the Sempra Agreement was "just too far from the paradigm to permit any meaningful comparison."

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Public Utilities Commission of the State of California	Docket Nos. EL02-60-000 and EL02-60-003
v.	
Sellers of Long Term Contracts to the California Department of Water Resources California Electricity Oversight Board	
v.	
Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources	Docket Nos. EL02-60-000 and EL02-60-003
	(Consolidated)

(Issued June 26, 2003)

Wood, Chairman, *concurring in part*:

In voting on this order, I do not agree with the ALJ's interpretation that the case law is now clear that where a contract fails to specifically provide that the contract may be unilaterally altered, Mobile-Sierra automatically requires that proposed changes to the contract meet the "public interest" standard of review. *See* Partial Initial Decision at ¶ 28. I concur in the conclusion that the public interest standard of review

applies to the contracts at issue in this case based solely on the specific evidence surrounding execution of those contracts and the parties' intent.

s/ Pat Wood III
Pat Wood, III
Chairman

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MASSEY, Commissioner, *dissenting*:

I am dissenting from this order, not because I relish abrogating contracts because I do not, but because I believe this Commission has a higher calling than simply the sanctification of long term contracts with prices reaching as high as $290 per MWh, contract prices that were multiples of traditional

prices, shockingly high prices, completely unprecedented by historic standards. Our primary calling under the Federal Power Act is to ensure that prices are just and reasonable 24 hours a day, seven days a week. When prices soar to unprecedented levels, when prices exceed a just and reasonable level by multiples, we have the obligation to make it right. That is the way I read the law.

Many of the contracts challenged here provide for prices that are unlawful by any reasonable measure, and there is no persuasive public interest rationale for sanctifying contracts negotiated during the height of the Western electricity crisis, where the skyrocketing prices in an out of control spot market in California strongly influenced long term contract prices, wildly dysfunctional market conditions clearly allowed for the exercise of market power, and there was "epidemic" manipulation of the market according to our staff's Western Markets Report.

Protecting contracts entered into in this horribly tainted environment violates the Federal Power Act's forceful declaration that contracts are absolutely unlawful and must be reformed if not just and reasonable. Turning Commission policy on its head, today's order will encourage wholesale electricity purchasers to "ride the spot market" because the Commission has shown a willingness to mitigate, and provide refund protection from, unjust and unreasonable spot market prices, at least in the California spot markets.[1] By the same token, buyers

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[1] In an case decided today, the Commission denies refund protection to spot market buyers in the Pacific Northwest during

will be discouraged from forward contracting because they will not enjoy protection from unlawful contract prices. Power buyers, consumers and retail policymakers will lose faith in the concept of wholesale electricity markets if they cannot trust the Commission to protect them from unjust and unreasonable contract terms resulting from a wildly dysfunctional market, market power and epidemic market manipulation.

The J&R standard is the appropriate standard of review in this instance

One of the fundamental questions that must be addressed in evaluating whether a contract must be reformed is the standard of review. Where there is clear language in the contract indicating that the parties intended that the "public interest" standard must be met before terms may be modified, then that is the appropriate standard. Where the contract lacks a clear statement of intent, the correct standard to apply is not that clear. Today's order finds that the more stringent public interest standard must be satisfied even for contracts with no clear statement of intent. I do not agree.

It is my view that except where the contract has a *Mobile-Sierra* clause restricting the right of the buyer to file a section 206 complaint, the just and reasonable standard applies. I concede that the law in this area is not the model of clarity, and the argument that the public interest standard controls is not without merit. Nevertheless, I believe a customer's

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the crisis period. Puget Sound Energy, Inc, 103 F.E.R.C. ¶ 61,348 (2003).

waiver of section 206 just and reasonable rights must be explicit. As the Commission observed in Order 888-A:

> We note that the fact that a contract may bind a utility to a Mobile-Sierra public interest standard does not necessarily mean that the customer is also bound to that standard. Unless a customer specifically waives its section 206 just and reasonable rights, the Commission construes the issue in favor of the customer.[2]

The Commission's proposed policy statement on standard of review is consistent with that position. The Commission would apply the just and reasonable standard of review unless specific language to the contrary is concluded in the contract.[3]

Perhaps more important, the just and reasonable standard should control the review of contracts negotiated *in the circumstances of this case* where the sellers were acting under a market-based pricing authorization granted by the Commission. The *Mobile-Sierra* doctrine arose in a cost-of-service regime. Once approved by the Commission as just and reasonable, a contract, rate or classification should not be modified unless a higher standard justifies the modification. This makes sense. Most cases arose in the context of a seller making a filing to justify a

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[2] Order No. 888-A, F.E.R.C. Stats. & Regs. ¶ 31,048 (1997) at 30, 191, footnote 31.

[3] Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 100 F.E.R.C. ¶61,145 (2002) at paragraph 7.

higher rate. In such a case, the doctrine appeared to have a customer protection rationale.

Today's order states that in a market based regime, the Commission's authorization for a public utility to sell at prices set by the discipline of the market, based upon a finding that the seller cannot exercise or has mitigated market power, amounts to a "predetermination" that any contract negotiated by such seller is just and reasonable. Hence, according to the majority, the just and reasonable standard of section 205 is satisfied, and a later contract modification would have to be justified by the higher public interest standard.

There are three flaws in this logic as applied here. First, virtually all of the Commission's orders granting market based pricing authority to the public utility sellers in the West explicitly declared that the Commission's action could not be construed as approving any contract negotiated pursuant thereto. These orders say:

> (t)his action does not constitute approval of any service, rate, charge, classification . . . or any . . . contract . . . affecting such rate or service . . . , nor shall such action be deemed as recognition of any claimed contractual right or obligation affecting or relating to such service or rate; and such action is without prejudice to any findings or orders which have been or may hereafter be made by the Commission in any proceeding . . .

Based upon this language, it seems clear that these contracts have never been approved as just and reasonable under section 205.

Second, even ignoring the rather plain language of the above-quoted paragraph, any possible presumption of the justness and reasonableness of contracts negotiated pursuant to the blanket authorization was flatly contradicted by the conclusions reached in the Commission's November 1, 2000 and December 15, 2000 orders, and in the July 2001 order requiring refunds. The November order found the market in California to be seriously flawed, and market conditions "have caused and continue to have the potential to cause, unjust and unreasonable rates for short term energy." Further: "There is clear evidence that the California market structure and rules provide the opportunity to exercise market power when supply is tight and can result in unjust and unreasonable rates."[4] In the December 15 order the Commission said that "we reaffirm our findings that unjust and unreasonable rates were charged and could continue to be charged, unless remedies are implemented."[5] It should be clear from both the breathtaking rise in prices after the December order and the June 2001 intervention by the Commission that the remedies in the December order did not work. Effective remedies were not put in place until June 2001 when the Commission imposed full time price controls. I would also note that the Commission's grant of market based pricing authority "depends on a functioning competitive market... unimpaired by market manipulation." Implicit in the grant of such authority is "a presumption that a company's behavior

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[4] San Diego Gas & Electric Company, 93 F.E.R.C. ¶ 61,121 (2000) at 61,349.

[5] San Diego Gas & Electric Company, 93 F.E.R.C. ¶ 61,294 (2000) at 61,999.

will not involve fraud or deception."[6] Circumstances indicate that this condition and presumption were not fulfilled. The Commission has found evidence of market manipulation in the California markets and is also investigating whether sellers withheld power from the market or engaged in excessive bidding.

In light of all of these circumstances, the predetermination rationale is without merit. The Commission's July 2001 order granting refunds for a nine month period beginning October 2, 2000 and ending June 19, 2001 was based upon a finding that during such period spot prices were not just and reasonable. It defies logic to rely upon a "predetermination" of justness and reasonableness contradicted by later Commission orders that reviewed real market conditions, found the opportunity to exercise market power, and required several billions of dollars in refunds based upon the explicit conclusion that actual prices charged in fact were not just and reasonable.

Third, the rates charged by sellers in the California spot markets were under the same regulatory scheme that produced the forward contracts at issue here, i.e., a preliminary finding at the certificate stage that a seller lacked or had mitigated market power and, hence, rates sought to be charged by such seller would by definition be just and reasonable. This "predetermination" applied equally to spot prices and to long term contract prices. Yet, in July 2001 the Commission wisely and correctly decided

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[6] Reliant Energy Services, et al, 102 F.E.R.C. 61,315 (2003) at paragraph 12; and Enron Power Marketing Inc., et al, 102 F.E.R.C.¶ 61,316 (2003).

to apply the just and reasonable standard to justify modifying the California spot prices and ordering refunds. Satisfying the public interest standard was not required. The Commission did not protect unjust and unreasonable spot prices (which were derived under tariff conditions and are akin to hourly contracts), yet decides today to protect unjust and unreasonable longer term transactions negotiated under the same regulatory framework. This distinction in the standard of review, based solely upon the length of the transaction, does not comply with sections 205 and 206 of the Act, and in my view is not reasoned decision making.

There is an additional reason that the just and reasonable standard should govern in this case. It is obvious that the buyers detrimentally relied upon the Commission's admonition in the December 2000 order that market participants enter into long term contracts.[7] In that same order, the Commission assured buyers that they would be protected from the exercise of market power. The Commission set a $74 MWh benchmark to use "in assessing any complaints regarding the justness and reasonableness of pricing of such long-term contracts negotiated under current market conditions."[8] The Commission promised to monitor prices "to address concerns about potentially unjust and unreasonable rates" in the long term markets.[9]

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[7] ". . . those who remain in the spot market for buying their residual load or selling their residual supply should be there in full recognition of the effects on price of last minute sales and purchases." 93 F.E.R.C. at 61,996.

[8] 93 F.E.R.C. at 61,982.

[9] 93 F.E.R.C. at 61,994.

The buyers reasonably relied upon the Commission's declaration that complaints about long term contracts would be judged according to just and reasonable standards and they would be protected. Given that reliance, it is simply unfair to adopt a standard of review today that gives these buyers substantially less protection. In addition, after the Commission declared in December 2000 that $74 MWh was a just and reasonable benchmark for long term contracts negotiated thereafter, it seems unconscionable now to validate contracts that allowed sellers to fetch upwards of $250 MWh, $260 MWh, and $290 MWh – multiples of the benchmark. The Commission effectively said to buyers "get into long term contracts, $74 is a reasonable benchmark price and, hey, don't worry, we'll protect you from unjust and unreasonable contract prices." Today's order utterly fails to keep that commitment.

The nexus between the California spot market and the forward contract market

A second fundamental issue in this case is whether the dysfunctional California spot markets adversely affected the long-term bilateral markets. I frankly do not understand why the hearing order in this case treated this as an open issue, and I said so at the time. The relationship between the spot market prices and long term contract prices seems rather obvious, and the Commission has explicitly recognized that "maintaining an accurately priced spot market is the single most important element for disciplining

longer term transactions."[10] In our Standard Market Design proposal, the Commission found that:

> Bilateral contracts generally reflect buyer and seller expectations of prices in spot markets. Therefore, market power mitigation in the organized spot market will effectively discipline market power in the bilateral markets as well [footnote omitted].[11]

More to the point, the Commission has specifically recognized the relationship between the California spot markets and bilateral markets in the West. Our November 1, 2000 order stated:

> Therefore, the operation of the California electricity market can affect prices throughout the entire Western Interconnection. The Staff Report demonstrates that during the summer of 2000 correlations between PX prices and Western bilateral prices were quite strong.[12]

And our June 19, 2001 mitigation order recognizes that "(t)here is a critical interdependence among the prices in the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward

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[10] AEP Power Marketing, 97 F.E.R.C. ¶ 61,219 (2001) at 61,972.

[11] Standard Market Design NOPR, 100 F.E.R.C. ¶ 61,138 (2002) at paragraph 405.

[12] 93 F.E.R.C. at 61,357 to 358.

markets."[13] Thus, it is beyond comprehension why there is any doubt on this issue.

But if there was any doubt whatsoever regarding whether there was a nexus between the spot and forward markets, the staff's Western Markets Report should dispel it. Staff's analysis found that there was a statistically significant relationship between spot and forward power prices during the period January 1, 2000 through June 30, 2001.[14] The contracts at issue here were negotiated during this time period. The Commission should respect staff's analysis. It was performed by a nationally recognized econometrician with a specialty in energy futures markets and with access to the most comprehensive database of forward power contracts for the period and locations in question. Thus, based on logic, the Commission's prior statements, and the conclusions of our staff's strong analysis, it is beyond dispute that the prices and other terms of the forward contracts at issue here were influenced by the California spot markets.

The just and reasonable standard is met

The prices and other terms of the forward contracts at issue here are unjust and unreasonable and should be reformed. I base this conclusion on three factors. First, the Commission has found that the California spot markets resulted in unjust and unreasonable rates for the refund period (October 2,

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[13] San Diego Gas & Electric Company, 95 F.E.R.C. ¶ 61,418 (2001) at 62,547.

[14] Western Markets Report at VI-18.

2000 to June 19, 2001). This is the period during which the contracts at issue here were negotiated. Second, the California markets were subjected to various forms of manipulation, which may have included withholding.[15] Third, there was a clear nexus between the California spot market and the forward contract markets. The unlawful California spot prices strongly influenced forward contract prices. And fourth, the prices in many of these contracts are multiples of the $74 MWh price the Commission had declared would be used as a rough just and reasonable benchmark.

The public interest standard is met

Even if the majority is correct and the appropriate standard of review is the public interest standard, these agreements still do not withstand scrutiny and must be reformed. The tone of today's order is that the *Mobile-Sierra* line of cases places a thumb heavily on the scale in favor of sanctity of contracts, and thus sets an exceptionally high threshold in meeting the public interest standard. While the threshold may be high, it is not as high as today's order would place it for the particular contracts at issue.

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[15] See Enron Power Marketing, Inc., et al, 103 F.E.R.C. ¶ 61,343 (2003) where the Commission revokes the market-based authorities and terminates the blanket marketing certificates of various Enron affiliates. See also American Electric Power Service Companies, et al, 103 F.E.R.C. ¶ 61,345 (2003), Enron Power Marketing, Inc. et al (2003) and Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, 103 F.E.R.C. ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

The *Mobile-Sierra* case law involves contracts negotiated under a cost of service regime, and thus we do not know how the courts would instruct the Commission to address contracts negotiated in a market-based regime, especially under market conditions characterized by dysfunctional market rules, widespread manipulative conduct, and a lack of effective regulatory oversight. We are on new ground here, and the Commission is free to decide what circumstances give rise to the public interest.[16] We are clearly not limited to the traditional three-prong test that gets so much attention. Today's order as well as court precedent point out that those three factors are only examples of what to consider in determining the public interest.[17] Indeed, the Commission has great discretion in carrying out its statutory responsibilities, even where the public interest standard controls:

> ... even if contracts fall within the scope of the Mobile-Sierra decisions, the Supreme Court has emphasized that the relevant agency, here FERC, may always reform a contract found to be 'unlawful" or 'contrary to the public interest,' i.e., that "contracts remain fully subject to the

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[16] "...nowhere in the Supreme Court opinion is the term 'public interest' defined. Indeed, the Court seems to assume that the Commission decides what circumstances give rise to the public interest." Northeast Utilities Service Company v. F.E.R.C., 55 F.3d 686, 690 (1st Circuit 1995).

[17] "This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." Northeast Utilities, 55 F.3d at 690. Also see today's order at paragraph 5.

paramount power of the Commission to modify them when necessary in the public interest."[18]

The Commission's order setting this case for hearing implicitly recognized our discretion in evaluating these contracts under the public interest standard when it held that "the Commission will not modify market based contracts unless there are extraordinary circumstances."[19] We are instructed by the courts that "(w)hen there is no reason to question what occurred at the contract formation stage, the parties may be required to live with their bargains."[20] What's at issue then is rendering judgement regarding whether there were extraordinary circumstances at play during the contract formation stage that warrant contract reformation.

In evaluating whether to reform contracts involving a seller with market-based authority, we must be guided by the market circumstances that affected the negotiations and contract terms. It has already been established that the conditions in the California markets infected markets across the West, including the forward contracts, such as those at issue in this case. What were the circumstances under which buyers negotiated these contracts?

- The structure and rules of California markets were flawed, market power

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[18] Northeast Utilities, 55 F.3d at 693.

[19] Public Utilities Commission of California v. Sellers of Long Term Contracts, 99 F.E.R.C. ¶ 61,087 (2002) at 61,383.

[20] Town of Norwood v. F.E.R.C., 587 F.2d 1306, 1312 (D.C. Cir. 1978).

could be exercised in them, unjust and unreasonable rates had been charged and the potential existed that unlawful rates could be charged in the future. This is what the Commission found in November and December of 2000.

- Due to a combination of factors, there was a shortage of electricity that resulted in unprecedented, high, volatile, and unjust and unreasonable prices in the spot markets. As a result, the Commission admonished buyers to move load into forward contracts or suffer the consequences.

- The electricity market during this same time frame was manipulated through a number of strategies by sellers. These are documented in the Western Markets Report and in orders decided today where the Commission requires more than fifty power sellers to defend against charges that they engaged in one or more manipulative strategies to pump up electricity prices.[21] The Commission is still investigating whether generation was strategically withheld from the market.

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[21] See American Electric Power Service Companies, et al, 103 F.E.R.C. ¶ 61,345 (2003), Enron Power Marketing, Inc. et al (2003) and Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, 103 F.E.R.C. ¶ 61,347 (2003) where the Commission establishes proceedings to investigate manipulative and questionable bidding behavior.

- During this same time frame, the price of natural gas, the fuel input for the marginal generation resources in the West, was manipulated by epidemic false reporting. This is documented in the Western Markets Report.

- As prices soared out of control, buyers had no basis to expect that this Commission would act forcefully to control them. The measures imposed in the December 2000 order were clearly ineffective and prices continued to rise. The Commission approved as just and reasonable spot prices of $273 MWh, $430 MWh and $300 MWh for the first three months of 2001, respectively,[22] and the Commission's then chairman reportedly advised Californians at the time that the only way out of the crisis was to "start putting shovels in the ground."[23]

This is the unprecedented environment in which these contracts were negotiated. The economic signals that formed the basis of the negotiations, and

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[22] See, respectively, 94 F.E.R.C. ¶ 61,245 (2001), 94 F.E.R.C. ¶ 62,245 (2001), and an unpublished Notice of Proxy Price for April Wholesale Transactions in the California Wholesale Electric Market issue by the Director, Office of Markets, Tariffs and Rates, April 16, 2001.

[23] Statement attributed to Chairman Hebert, San Francisco Chronicle, April 12, 2001 (as reported on the San Francisco Chronicle's web site - - www.sfgate.com.)

consequently the contract terms, were severely tainted. Buyers had their backs to the wall under these circumstances and essentially negotiated out of fears of yet higher prices or blackouts for their customers. Such conditions, spread over an area as large as the western United States, are truly extraordinary. And those conditions had extraordinary effects. For example:

- This Commission found it necessary in June 2001 to cap prices across this entire thirteen state region, 24 hours a day, seven days a week.[24] Such broad market intervention by this agency was unprecedented.

- A major California utility, Pacific Gas and Electric, declared bankruptcy as a direct result of the crisis and a second utility, Southern California Edison, teetered on the edge of bankruptcy.

- Local economies suffered devastating effects as a result of these market conditions. In the Pacific Northwest, factories closed and jobs were lost. The aluminum industry has exited the region for all intents and purposes.

- The movement toward competitive electricity markets at the national and state levels was almost brought to a halt. Consumers and policymakers were

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[24] San Diego Gas & Electric Company, 95 F.E.R.C. ¶ 61,418 (2001).

shocked and outraged that an out of control electricity market could wreak such havoc.

The tainted atmosphere in which these contracts were negotiated was unprecedented and extraordinary. The most influential benchmark used in negotiating forward contracts - - the spot market and expectations of future spot prices - - was wildly dysfunctional. When these contracts were negotiated, the Commission had already declared that conditions in the California markets allowed the exercise of market power and rates were unjust and unreasonable. And we now know that there was unprecedented manipulation of both the natural gas and electricity markets and epidemic false reporting of natural gas trading data.

There is simply no persuasive public interest rationale for protecting and sanctifying contracts negotiated in this unprecedented and extraordinary environment. Those market conditions certainly tainted any contracts negotiated during this time frame. It would simply defy logic to conclude that the high prices in these contracts were not

adversely influenced by market conditions that included the exercise of market power and widespread market manipulation. Upholding such contracts violates the public interest. These contracts must be reformed.

Remedy

I would remand this case to an Administrative Law Judge to determine specifically how each contract

should be reformed. I would also recommend that the judge use the method set out in staff's Western Markets Report for determining the mitigated price in each contract. I suggest this method because staff's analysis has great credibility - - it had access to the most comprehensive data base of forward price contracts for the period and locations in question.

Staff's econometric analysis estimates the statistical relationship between spot power prices and forward contract prices (the "spot power elasticity"). This relationship shows how much forward prices rise for each percentage increase in spot prices. Staff also developed a formula representing the relationship between the degree to which spot power prices were excessive and the appropriate level for mitigated forward prices. This formula can be used to set mitigated forward contract prices. The excessiveness of spot prices (or the "spot power distortion" in staff's formulation) can be estimated by using the mitigated market clearing prices (MMCPs) being developed in the California refund proceeding. The MMCPs will represent the just and reasonable prices in the California spot markets. The spot power distortion can then be plugged into staff's formula to develop the mitigated forward prices.[25]

For these reasons, I dissent from today's order.

s/ William L. Massey
William L. Massey
Commissioner

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[25] See pages V-16 to V-18 of the Western Markets Report.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Public Utilities Commission of the State of California	Docket Nos. EL02-60-000 and EL02-60-003
v.	
Sellers of Long Term Contracts to the California Department of Water Resources California Electricity Oversight Board	
v.	
Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources	Docket Nos. EL02-60-000 and EL02-60-003
	(Consolidated)

(Issued June 26, 2003)

BROWNELL, Commissioner, *concurring*

1. I have been very clear in my prior statements about my belief in the sanctity of contracts. However, the issue of how to weigh contract sanctity in the context of the Western power crisis is, to say the least, a very difficult one, and I have struggled with it. The parties in this case were afforded the opportunity of a trial-type hearing and I have reviewed the evidence

developed during that hearing. I have read the ALJ's Initial Decision and considered the parties' briefs on that Decision. I have also reviewed Staff's Final Report on Price Manipulation in Western Markets and the evidence submitted in the 100-Day Discovery Proceeding in the context of this case. Finally, the Commission took the unusual step of providing the parties an additional opportunity to address the issues in an oral argument before the Commission itself, and I have carefully considered all points raised during that oral argument. After reviewing all of this information, I agree with the order's conclusion that these were contracts voluntarily entered into and the Complainants have not met their burden of proving that the contracts are contrary to the public interest.

2. I am writing separately to express my concern about one aspect of the order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the contracts' silence as to the buyer's right to seek unilateral changes under section 206.[1] Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the

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[1] Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, *et al.*, 99 F.E.R.C. ¶ 61,087 (2002) (citing Texaco Inc. v. F.E.R.C., 148 F.3d 1091, 1096 (D.C. Cir. 1998) and Boston Edison Co. v. F.E.R.C., 233 F.3d 60, 67 (1st Cir. 2000)).

absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[2]

3. This order could have simply affirmed the ALJ's conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do. Unfortunately, today's order fails to do so and instead bases the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The *Mobile-Sierra* doctrine is not an invention of the FERC that we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the parties' intent in future contract abrogation cases.

s/ Nora Mead Brownell
Nora Mead Brownell

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[2] Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, *et al.*, 102 F.E.R.C. ¶ 63,013 at P 28 (2003); Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., *et al.*, 101 F.E.R.C. ¶ 63,031 at P 27 (2002); and PacifiCorp v. Reliant Energy Services, Inc., *et al.*, 102 F.E.R.C. ¶ 63,030 at P 18 (2003).

APPENDIX R

105 FERC ¶ 61,182

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and
Nora Mead Brownell.

Public Utilities Commission of the State of California

Docket Nos. EL02-60-000
v. EL02-60-003
EL02-60-004

Sellers of Long Term Contracts to the California Department of Water Resources

California Electricity Oversight Board

Docket Nos. EL02-62-000
v. EL02-62-003
EL02-62-004

Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources (Consolidated)

ORDER ON REHEARING AND CLARIFICATION

(Issued November 10, 2003)

1. On February 25, 2002, the Public Utilities Commission of the State of California (CPUC) and the California Electricity Oversight Board (CEOB) (collectively, "Complainants") filed complaints seeking to modify certain long-term contracts entered into between the California Department of Water Resources (CDWR) and more than twenty-four (24) sellers.[1] As a result of withdrawals and dismissals, only four sellers remain in this proceeding. [2] They are Mirant America Energy

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[1] *See Public Utilities Commission of California v. Sellers of Long Term Contracts,* 103 F.E.R.C. ¶ 61,354 n.21 (June 26 Order).

[2] *Id.* We also granted withdrawal of the complaints as to Allegheny *Energy Supply Company, LLC (Allegheny) on July 11, 2003. Public Utilities Commission of California v. Sellers of Long Term Contracts,* 104 F.E.R.C. ¶ 61,074 (2003).

On August 6, 2003, Complainants moved to dismiss with prejudice their complaints against El Paso Merchant Energy, L.P. (El Paso) as Complainants and El Paso have reached a comprehensive settlement (Master Settlement Agreement) resolving Complainants' claims against El Paso in this proceeding. Complainants further request that the dismissal be void ab initio if the Effective Date under the Master Settlement Agreement never occurs. We grant Complainants' motion and dismiss their complaints as to El Paso with prejudice. *See also Rule 216 of the Commission's Rules of Practice and Procedure,* 18 C.F.R. § 385.216 (2003). This dismissal will be void *ab initio* if the Effective Date under the Master Settlement Agreement never occurs.

Marketing, LP (Mirant); Coral Power, L.L.C. (Coral); Dynegy Power Marketing, Inc. (Dynegy); and Sempra Energy Resources (Sempra). The complaints allege that the prices, terms and conditions of the contracts are unjust and unreasonable and, to the extent applicable, not in the public interest, and that the respondents obtained the prices, terms and conditions in the contracts through the exercise of market power in violation of the Federal Power Act (FPA).

2. On June 26, 2003, we denied the complaints.[3] In this Order, we deny the requests for rehearing, reaffirm our conclusion that the record in this proceeding does not support modification of the contracts at issue for the reasons stated below, and address the request for clarification. This Order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the *Mobile-Sierra*[4] doctrine.

On September 25, 2003, Complainants moved to withdraw with prejudice their complaints as to Morgan Stanley Capital Group, Inc. Consistent with *Rule 216 of the Commission's Rules of Practice and Procedure,* 18 C.F.R. § 385.216 (2003), the withdrawal has become effective by operation of law.

On April 25, 2002, we dismissed the complaints as to contracts entered into after June 20, 2001. *Public Utilities Commission of California v. Sellers of Long Term Contracts,* 99 F.E.R.C. ¶ 61,087 at 61,383-84 (April 25 Order), *order on Reh'g,* 100 F.E.R.C. ¶ 61,098 (2002) (July 23 Order).

[3] June 26 Order, 103 F.E.R.C. ¶ 61,354.

[4] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *FPC v. Sierra Pacific Power,* 350 U.S. 348 (1956) (*Sierra*).

I. Background

3. In the April 25 Order, we found that the Mirant and Coral contracts contained explicit provisions limiting the contracting parties' rights to make unilateral FPA Section 205 or Section 206 filings, as well as the FPA Section 206 rights of third parties, to amend the contract, and, therefore, Complainants would have to satisfy the public interest standard of review set out in *Mobile-Sierra* to justify the requested contract modification.[5]

4. As for the contracts that did not contain explicit *Mobile-Sierra* provisions (the Dynegy and Sempra contracts), we found the record was insufficient to determine whether Complainants would face a *Mobile-Sierra* burden of proof or the FPA Section 206 just and reasonable burden of proof to justify modification.[6] Thus, we "set for hearing the issue of whether the complainants must bear the burden of showing that [the Dynegy or Sempra] contract[s] [are] contrary to the public interest, or whether they will bear the burden of showing that the contract[s] [are] not just and reasonable."[7]

5. We also set for hearing, as to the Mirant, Coral, Dynegy, and Sempra contracts, the limited issue of "whether the dysfunctional California spot markets adversely affected the long-term bilateral markets, and, if so, whether modification of any

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[5] April 25 Order, 99 F.E.R.C. at 61,383.

[6] *Id.*

[7] *Id.*

individual contract at issue is warranted."[8] If the Administrative Law Judge (ALJ) were to conclude that modification of one or more of the contracts was warranted, she was not to determine how those contracts should be modified.[9] "The evidentiary hearing was established to, among other things, interpret the terms of [the contracts at issue] and to ascertain the intent of the parties at the time these contracts were signed."[10]

6. On December 17, 2002, we directed the ALJ to omit the initial decision as to contracts containing explicit *Mobile-Sierra* provisions and to certify the record as to those contracts directly to the Commission.[11] Then, on January 10, 2003, we again instructed the ALJ to "determin[e] which standard of review applies to the contracts not containing explicit *Mobile-Sierra* language" and clarified that:

[a]s to the contracts for which the Presiding ALJ finds the applicable standard of review to be the 'just and reasonable' standard, the ALJ should then address the question of whether the 'just and reasonable' standard has been met. As to the contracts for which the Presiding ALJ determines that the applicable standard of review is the 'public interest' standard, the ALJ should certify the record directly to the Commission. The Commission will then determine whether the 'public interest'

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[8] *Id.* at 61,384 (footnote omitted).

[9] *Id.*

[10] July 23 Order at 61,393.

[11] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 101 F.E.R.C. ¶ 61,293 (2002).

standard has been met.[12]

7. On January 16, 2003, after holding an evidentiary hearing held on December 2-12, 2002, the ALJ issued an initial decision on the limited burden of proof/standard of review issue we directed and certified the record to us for determination of all remaining issues. [13] The ALJ found that each contract's language and the evidence presented at the hearing persuasively demonstrated that the contracting parties did not, nor did they intend to, preserve their rights to make unilateral application to the Commission for modification of the contracts.[14]

Dynegy Contract

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[12] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 102 F.E.R.C. ¶ 61,025 at P 13 (2003).

[13] *Public Utilities Commission of California v. Sellers of Long Term Contracts*, 102 F.E.R.C. ¶ 63,013 (2003) (Partial Initial Decision).

[14] *Id.* at P 43 (citing, e.g., Exh. SER-1 at 34:6-26, 34:10-26 (Niggli); Exh. SER-32 at 6:17-28 (*Niggli*); Exh. DYN-1 at 33:10-34:5 (*Lednicky*)); *id.* at P 45. The ALJ noted that "the extrinsic evidence of record indicate[d] that the State had very little confidence in the Commission as an avenue for relief at the time these contracts were negotiated, that CDWR negotiated the subject contracts in a 'crisis' environment, and that for various reasons CDWR's negotiating team focused almost exclusively on the pricing terms of the subject contracts. In fact, at least one witness testified that precluding unilateral application to the Commission for changes in rates, terms and conditions was an issue of importance to CDWR and that the parties agreed to language to this effect in their executed contract." *Id.* at P 43.

8. The ALJ explained that, while the Dynegy contract did not contain a provision specifically addressing the parties' FPA Section 205 or Section 206 rights, a provision in a subpart of the contract (Section 8, paragraph F of the System Contingent Capacity Purchase and Sales Agreement) "appears to limit CDWR's right to take any action which is inconsistent with the just and reasonable nature of the rates..."[15] That section provides that:

CDWR acknowledges and agrees that all payments to [Dynegy] hereunder,... are 'just and reasonable' within the meaning of Section 451 of the Public Utilities Code and that CDWR shall not take any action or fail to take any action which is inconsistent with the just and reasonable nature of such payments.[16]

9. The ALJ also noted witness testimony that "Dynegy insisted on this provision, otherwise Dynegy would not have had any assurance of payment and no assurance that CDWR would not later seek to devise a way to abrogate the contract."[17] That same witness asserted that "any argument advanced by, or on behalf of CDWR, that the FERC can or should review and determine whether the Agreement, or payments under the Agreement are 'just and reasonable' is the taking of an action 'inconsistent with the just and reasonable nature of the payments' and is expressly prohibited

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[15] *Id.* at P 37.

[16] *Id.* (quoting Exh. DYN-2 at EOB-DYN-1-0005286).

[17] *Id.* (citing Exh. DYN-1 at 33:6-9).

by the Agreement."[18]

10. Although acknowledging that "this Commission's determination regarding whether a rate is just and reasonable is not governed by Section 451 of the Public Utilities Code," the ALJ found that Section 8, paragraph F of the System Contingent Capacity Purchase and Sales Agreement:

suggest[s] that the parties agreed that they would not take any action which is inconsistent with the presumed just and reasonable nature of the rates in this contract. Accordingly, and because the contract is otherwise silent with respect to the parties' Sections 205 and 206 rights,... the *Mobile-Sierra* 'public interest' standard should be applied in this instance.[19]

Sempra Contract

11. The ALJ found that one provision in the Sempra contract addresses the parties' rights under FPA Sections 205 and 206[20]:

> FERC. The Parties acknowledge that (i) this agreement provides for wholesale power sales subject to the jurisdiction of the FERC under the FPA; and (ii) the rates, terms and conditions of this Agreement are 'just' and

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[18] *Id.* (quoting Exh. DYN-1 at 33:15-34:5).

[19] *Id.* at P 38 (citing Exh. S-4 at 10:15-12:10); *see id.* at P 43.

[20] *Id.* at P 41 (citing Section 10.03 of the Energy Purchase Agreement).

> 'reasonable' within the meaning of the FPA and that changes in market conditions will not render such rates, terms and conditions 'unjust' or 'unreasonable' for purposes of Section 206 of the FPA.[21]

12. The ALJ further noted the explanation of Sempra's witness that, initially, Sempra proposed contract language that would give both CDWR and Sempra the unilateral right to seek contract modification, but, because CDWR did not want FERC to have the ability to review the rates, terms and conditions of the contract, they agreed to alter the contract to limit the unilateral right of either Sempra or CDWR to modify the contract's rates, terms or conditions of service.[22] Based on the contract language quoted above and the cited witness testimony, the ALJ concluded that the *Mobile-Sierra* public interest standard applies to the Sempra contract.[23]

13. In addition, the ALJ noted Complainants' concession that they:

> have not argued, or submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provision in the [Dynegy and Sempra] contracts is itself a basis for not applying the *Mobile-Sierra* standard to those contracts. Accordingly, to the extent the *Mobile-Sierra* standard applies to the contracts with explicit

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[21] Id.

[22] *Id.* at P 42 (citing Exh. SER-1 at 34:10-26).

[23] *Id.* at P 42 (citing Exh. S-4 at 15:14), P 43, P 45.

Mobile-Sierra provisions, it applies to the contracts without such provisions.[24]

14. The ALJ further explained the basis of her determination that unilaterally proposed changes to the Dynegy and Sempra contracts are subject to review under the *Mobile-Sierra* public interest standard.[25]

As here, where the contract has not preserved the rights of a party to seek unilateral modifications, the finding that the *Mobile-Sierra* standard of review applies to a negotiated contract unless the contract expressly states otherwise serves to protect the expectations of contracting parties that their negotiated agreement will be respected, thus promoting stability of contracts, stability of the market as a whole, and protecting ratepayers by encouraging the utilization of contracts to reduce reliance on the more costly and volatile spot market, while still protecting the 'public interest' as required by the remedial protections afforded to consumers under the FPA.[26]

15. The parties submitted initial trial and reply briefs as well as briefs on exceptions to the Initial Decision and oppositions thereto. Also, on May 15,

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[24] *Id.* at P 44 (quoting Complainants' January 14, 2003 Answer to Motion to Hold Briefing in Abeyance).

[25] *Id.* at P 43.

[26] *Id.* at P 45 (citing *Texaco Inc. v. FERC*, 148 F.3d 1091, 1095 (D.C. Cir. 1998) (*Texaco*); *Town of Norwood v. FERC*, 202 F.3d 392, 400 (1st Cir. 2000); *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983) (*Papago*)).

2003, we held oral argument.

16. On June 26, 2003, we affirmed the ALJ's finding that the public interest standard of review applies to all the contracts at issue without explicit *Mobile-Sierra* language.[27] In doing so, we explained the genesis and parameters of the *Mobile-Sierra* doctrine, its public interest standard, and their impact on our review of requests for contract modification.[28] As we explained, the *Mobile-Sierra* cases and their progeny hold that, where parties contract for a particular rate and do not reserve their rights to unilaterally propose a rate change, a party cannot unilaterally file for a new rate and the Commission cannot act under the FPA just and reasonable standard to supersede the contractually agreed-upon rate. [29] Rather, we can grant a unilateral request to alter a contract under which the requesting party did not reserve its rights to unilaterally propose a rate change only if the proposed change is required by the "public interest."

17. We also denied the complaints, finding that Complainants did not meet their burden of proof under the public interest standard to justify modifying any of the contracts still at issue in this proceeding. [30] Based upon our review of the evidentiary record developed in this proceeding, the findings of the Commission Staff's Final Report on

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[27] June 26 Order, 103 F.E.R.C. at P 3.

[28] *Id.* at P 4-7.

[29] *Id.* at P 4 (citing *Boston Edison Co. v. FERC*, 233 F.3d 60, 64-65 (1st. Cir. 2000)).

[30] *Id.* at P 3.

Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report), evidence submitted in the 100-Day Discovery Proceeding in Docket No. EL00-95, et al., and the totality of the circumstances, we concluded that the Complainants failed to meet their burden of proof under the public interest standard of review.[31] As Complainants devoted most of the evidentiary hearing and briefing to attempting to demonstrate that the contracts were unjust and unreasonable, we found that they presented very little evidence relevant to the *Mobile-Sierra* public interest standard that applies here.[32] We also found that the Complainants failed to demonstrate that the contracts in question caused financial distress for the Complainants (or others they represent), threatening their ability to continue service; that the contracts cast an excessive burden on customers; that the contracts were unduly discriminatory; or any other factors showing that modifying the contracts is required by the public interest.[33]

18. For example, we found that, through these contracts, CDWR achieved one of its central objectives of having a portfolio that yields a weighted average price no higher than $70/MWh, the average cost of energy supply reflected in IOUs' retail rates, as of January 2001.[34] In securing its

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[31] Id. at P 3, 8.

[32] *Id.* at P 39.

[33] *Id.* at P 8, 39.

[34] *Id.* at P 40 (citing Exh. CAL-51 at 10:24-11:3; Exh. AYE/SER-7 at 70:22-71:4 (Hart deposition); Exh. AYE/SER-11 at 64:11-66:2 (Nichols deposition); Tr. at 1258:14-1260:9;

contracts, CDWR also achieved an overall portfolio that is diversified both in terms of energy products and durations.[35] Furthermore, the evidence did not show that the contracts were priced above long-run competitive prices.[36] Nor did Complainants present evidence to support a finding that the contracts are unduly discriminatory or preferential to the detriment of other purchasers who are not parties to the contract.[37]

19. We further found that the extensive evidentiary record regarding the totality of circumstances preceding and following the execution of the contracts at issue shows that CDWR had options and at least some bargaining power when it entered into this portfolio of contracts after often protracted negotiations.[38] When the contracts were executed, alternatives were available; the parties voluntarily chose to enter into the contracts, accepting market risks.[39]

20. Additionally, we found nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there

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Exh. S-8 at 16:2-23; Exh. CAL-70 at 13 of *Update of California Department of Water Resources Power Purchase Contract Efforts* dated May 31, 2001 (May 31, 2001 CDWR Update); Exh. CAL-51 at 31:16-19; Exh. DYN-1 at 16:25-27).

[35] *Id.* (citing Exh. DYN-38 at 1).

[36] *Id.* (citing Exh. MAEM-25 at 6:20-9:22; Exh. COR-48; Exh. COR-50; Exh. CAL-163 at 1:22-2:7).

[37] *Id.* at P 41 (citing *Papago*, 723 F.2d at 953 n.4).

[38] *Id.* at P 42-60 (citing numerous record exhibits).

[39] *Id.* at P 8.

was market manipulation specific to the long-term contract negotiations resulting in the prices and terms challenged here.[40] There was no evidence to support a finding of unfairness, bad faith, or duress in the original negotiations. [41] That left dissatisfaction with the bargain as the only basis for contract modification, a.ı insufficient basis under the public interest standard.[42]

21. Requests for rehearing were filed by Public Utility District No. 1 of Snohomish County, Washington (Snohomish), Californians for Renewable Energy (CARE), jointly by Complainants, and jointly by Coral, Dynegy, Mirant and Sempra (Indicated Sellers). Sempra filed an answer to Complainants' request for rehearing, and Complainants filed an answer in response.

II. Discussion

A. Procedural Matters

1. Ex Parte Allegations

22. Complainants request that we vacate the June 26 Order and that Chairman Wood and Commissioner Brownell recuse themselves from

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[40] *Id.* at P 61.

[41] *Id.* at P 62.

[42] *Id.* at P 8, 62 (citing *Potomac Electric Power Company v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000) (*PEPCO*); *Soyland Power Cooperative, Inc. v. Central Illinois Public Service Company*, 51 F.E.R.C. ¶ 61,004 at 61,013, *Reh'g dismissed as moot*, 52 F.E.R.C. ¶ 61,149 (1990); *Papago*, 723 F.2d at 953; *Sierra*, 350 U.S. at 354-355).

further proceedings in this matter because, after a Commission open meeting and press conference, Chairman Wood and Commissioner Brownell briefed a group of Wall Street analysts, via a telephone conference, about the open meeting.[43] We deny Complainants' requests.

23. We incorporate and reiterate our finding in an order issued in Docket No. EL02-28 on April 23, 2003,[44] and in an order denying rehearing in that same docket issued contemporaneously with this Order,[45] that the telephone conference briefing, in which the Chairman and Commissioner Brownell simply repeated what they already had discussed at the open meeting and provided general background information, was not an inappropriate ex parte communication and did not taint this proceeding.[46] Complainants' proffered statements from the Special Inquiry findings do not change this conclusion. In fact, those findings "did not identify evidence, based on that available record, substantiating the allegation that the conduct of the call violated any Commission procedural rule" and explained that "[n]one of [the 17 Wall Street representatives from 12 companies interviewed, nine of whom

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[43] Complainants' *Reh'g Request* at 2, 73-75 (citing Special Inquiry findings issued by the U.S. Department of Energy Office of the Inspector General on June 27, 2003 (Special Inquiry findings)).

[44] *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al.*, 103 F.E.R.C. ¶ 61,080 (2003).

[45] *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., et al.*, Docket No. EL02-28-004, *et al.*

[46] *Nevada Power Company, et al., v. Enron Power Marketing, Inc., et al.*, 103 F.E.R.C. ¶ 61,080 (2003).

acknowledged participating in some or all of the conference call] stated that Chairman Wood or Commissioner Brownell explicitly indicated, during the conference call, how they would vote on the contract cases."[47]

24. Neither the Chairman nor Commissioner Brownell has prejudged the issues here, and, contrary to Complainants' assertion,[48] neither has had any "ex parte commitments." Vacation of the June 26 Order and recusal of the Chairman and Commissioner Brownell are therefore neither necessary nor appropriate in this case. We also reiterate our finding in the June 26 Order, at Appendix B, that Complainants' motion for disclosure of the telephone conference briefing is moot, as a summary of events relating to that briefing was filed in the record on April 22, 2003.

25. Even assuming the conference call was a prohibited off-the-record communication, the violation has already been remedied, as disclosure, not recusal, is the appropriate remedy. Administrative proceedings blemished by ex parte communications may be remedied administratively by disclosing the communication and its contents.[49] In this regard, in the context of a Commission case, the court found that, by placing summaries of

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[47] Special Inquiry findings, DOE/IG - 0610 June 2003, Results of the Inquiry p. 3.

[48] Complainants' *Reh'g Request* at 2.

[49] *See* 5 U.S.C. § 557(d)(1)(C)&(D); *Professional Air Traffic Controllers Organization v. Federal Labor Relations Authority*, 685 F.2d 547, 565 n.36 (1982).

meetings Commission officials held with industry officials, other parties were apprised "of any argument that may have been presented privately, thereby maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused."[50]

26. In addition, in Louisiana, the court made clear that recusal was not necessary or desirable even though there may have been ex parte communications.[51] Recusal here, therefore, would be an extraordinary and unwarranted remedy.[52] In Power Authority of the State of New York, the court explained that:

> recusal would be required only if the communications posed a serious likelihood of affecting the agency's ability to act fairly and impartially in the matter before it. In resolving that issue, one must look to the nature of the communications and particularly to whether they contain factual matter or other information outside of the record, which the parties did not have an

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[50] *Louisiana Ass'n of Indep. Producers v. FERC*, 958 F.2d 1101, 1112 (D.C. Cir. 1992).

[51] *Id.* (citing *FTC v. Cement Inst.*, 333 U.S. 683, 702 (1948) ("It is expected that administrative official will build up expertise through experience with recurring issues.") and *Laird v. Tatum*, 409 U.S. 824, 837 (1972) ("Such expertise should not lightly be tossed aside.")).

[52] *See Power Authority of the State of New York v. FERC*, 743 F.2d 93, 110 (2d Cir. 1984) ("The mere existence of such communications hardly requires a court or administrative body to disqualify itself.").

opportunity to rebut.[53]

27. As described above, the conference call contained no factual matter or other information outside the record, and, even assuming it did, Complainants had ample chance to rebut it at the oral argument or by filing a response.

2. Mirant Bankruptcy

28. On September 12, 2003, the Bankruptcy Court for the Northern District of Texas issued a "Temporary Restraining Order Against the Federal Energy Regulatory Commission" (TRO) in In re Mirant Corp. (*Mirant Corp. v. FERC*), Adversary Proceeding No. 03-4355, which enjoins the Commission "from taking any action, directly or indirectly, to require or coerce the [Mirant] Debtors to abide by the terms of any Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the court unless FERC shall have provided the Debtors with ten (10) days' written notice setting forth in detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this paragraph."

29. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Commission will appeal that order. Despite the Commission's disagreement with the validity of the TRO and its expectation that

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[53] *Id.*

the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days' written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this Order requires Mirant to act in a manner proscribed by the TRO, the Order will provide written notice to Mirant of the action that FERC will take with respect to a covered Mirant Wholesale Contract, which action will not become effective until ten (10) days after issuance of this Order. In all other respects, this Order is effective immediately.

3. Other Procedural Matters

30. On July 26, 2003, as amended on September 2, 2003 and September 5, 2003, CARE filed a request for rehearing in this proceeding. As CARE acknowledged, it is not a party in this proceeding,[54] and it has not sought to intervene. As requests for rehearing can only be filed by parties,[55] we will dismiss CARE's request for rehearing.

31. Rule 713(d) of the Commission's Rules of Practice and Procedures, 18 C.F.R § 385.713(d) (2003), prohibits answers to requests for rehearing. Accordingly, we will reject Sempra's motion for leave to file a limited answer to Complainants' request for rehearing. Under Rule 213(a) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(2003), no answer may be made to a protest

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[54] CARE *Reh'g Request* at n.6.

[55] 18 C.F.R. § 385.713(b) (2003).

or answer unless otherwise ordered by the decisional authority. Good cause does not exist to justify accepting Complainants' answer to Sempra's motion to file a limited answer; therefore, we will reject this answer.

B. Substantive Issues

1. Whether The Public Interest Standard Applies.

32. Complainants and Snohomish argue that, in the June 26 Order, the Commission violated its statutory obligation to ensure just and reasonable rates when it determined that it could impose a higher burden of proof before mitigating unjust and unreasonable prices in the contracts at issue. They state that the Commission can apply the public interest standard to determine whether prices should be mitigated only after its finds that the contract prices at issue here are just and reasonable.

33. As discussed below, the Commission has not violated its statutory obligation with respect to modification of contracts, as interpreted by the U.S. Supreme Court. The *Mobile-Sierra* doctrine holds that in cases "where parties have negotiated a... contract that sets firm prices... and that denies either party the right to change such prices [] unilaterally, [the Commission] may abrogate or modify the contract only if the public interest so requires."[56] Under the public interest standard, the sole concern of the Commission is whether the

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[56] Texaco, 148 F.3d at 1095.

challenged rate adversely affects the public interest, [57] and the Commission can exercise its authority to modify contracts only where the public interest demands such action. [58] The burden to demonstrate that the contract rates in question in this proceeding are contrary to the public interest is on the Complainants. The Complainants in this proceeding, however, have failed to make such a showing. As established in the June 26 Order and affirmed in this order on rehearing, the contracts at issue are subject to the public interest standard of review. Once a party signs a *Mobile-Sierra* contract, it cannot escape by later claiming that the rates were not just and reasonable when it signed the contract, unless there is evidence such as the seller fraudulently inducing the buyer to execute the contract. However, no such evidence was found in the evidentiary record, including the Staff Report and the 100-Day Discovery Proceeding submittals.

34. In response to the Complainants' arguments that the Commission can apply the public interest standard of review only after it finds that the contract rates were just and reasonable, [59] Complainants fail to acknowledge that the contracts were lawfully entered into pursuant to prior findings and authorization by the Commission under Section 205 of the FPA. [60] Upon a showing that the seller

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[57] Sierra, 350 U.S. at 354-5.

[58] *Union Pacific Fuels, Inc.*, 129 F.3d 157, 161 (D.C. Cir. 1997) (quoting *Metropolitan Edison Co. v. FERC*, 595 F.2d 851, 856 n.29 (D.C. Cir. 1979)).

[59] *See also* Snohomish *Reh'g Request* at 11, 12, 14-15, 18-22, 35.

[60] 16 U.S.C. § 824d (2000).

lacks or has mitigated market power in the relevant market, the Commission pre-determines under Section 205 of the FPA that sales at market-based rates will be just and reasonable.[61] In effect, the Commission makes a "blanket" just and reasonable determination which applies to subsequent market-based sales made by the seller. As we explained in our June 26 Order, if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of authority a pointless exercise of no value to anyone.

35. The Commission has held that this grant of market-based rate authority constitutes what is known as the "initial review" of rates in the cost-based rate context. Then, if the parties have not agreed to apply the public interest standard to future challenges, a party may come to the Commission pursuant to Section 206 of the FPA[62] and demonstrate that the rate is no longer just and reasonable. Alternatively, a party who does not have such a right may seek changes by demonstrating that the contract rate is contrary to the public interest. In essence, the Complainants and Snohomish attempt to add another layer to this two-step process, claiming that parties to contracts that are subject to the public interest standard of review should have another opportunity to argue that the rate was not just and reasonable at the outset. This argument, however, has no support in either the

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[61] *Louisiana Power Authority v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993).

[62] 16 U.S.C. § 824e (2000).

statute or the relevant Commission or court precedent. Indeed, the Complainants' suggested approach would create uncertainty in the market, as a party who suddenly finds that its deal has become uneconomical, can undo the terms to which it was contractually bound. This is precisely what the *Mobile-Sierra* doctrine was designed to avoid, and we see no support for an exception to this established doctrine simply because a party has contracted in a market-based rate regime.

36. Our decision in Lockyer[63] supports this result. The "view that only cost-based or formula rate models satisfy the statutory framework fundamentally misapprehends the Commission's ratemaking authority."[64] Lockyer held that market-based rate certificates satisfy the FPA Section 205(c)[65] requirement that rates be on file with the Commission and recognized that the Commission reviews the reasonableness of the use of market-based rates prior to their effectiveness. "Prior review consists, however, not of the particular prices agreed to by willing buyers and sellers. Rather, it consists of analysis to assure that the seller lacks or has mitigated market power so that its prices will fall within a zone of reasonableness."[66]

37. Thus, at the time sellers are granted market-based rate certificates, their rates are subject to the

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[63] *State of California ex re Lockyer v. British Columbia Power Exchange Corp;, et al.*, 99 F.E.R.C. ¶ 61,247 (2002) (*Lockyer*).

[64] *Id.* at 62,062.

[65] 16 U.S.C. § 824d(c) (2000).

[66] Lockyer, 99 F.E.R.C. at 62,063.

initial review required by the FPA. This review is different than that conducted for cost-based rates because "[t]he availability of genuine alternatives provides a sufficient basis... to conclude that 'market discipline' will be sufficient to keep the prices that sellers charge within the statutorily-prescribed just and reasonable zone." [67] We reject the parties' argument that this approach is insufficient to satisfy the statute. Our decision in Lockyer is on all fours with our finding here.

38. Indicated Sellers seek clarification that the public interest standard of review does not authorize unjust and unreasonable rates. We clarify as follows. Indicated Sellers are correct that rates initially must be just and reasonable. For market-based rates, this determination is made when the authorization for market-based rates is granted. However, if rates subsequently become unjust and unreasonable and the contract at issue is subject to the *Mobile-Sierra* standard of review, the Commission under court precedent may not change the contract simply because it is no longer just and reasonable. If parties' market-based rate contracts provide for the public interest standard of review, the Commission is bound to a higher burden to support modification of such contracts. The public interest standard applies to changes to contract rates and "represents the Supreme Court's attempt to strike a balance between private contractual rights and the regulatory power to modify contracts when

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[67] *Id.*

necessary to protect the public interest." [68] Our finding that changes to the challenged contracts should be evaluated under the public interest standard does not equate to a finding that the underlying rates are not just and reasonable. To the extent Indicated Sellers' request for clarification asks the Commission to opine on matters not before us in this case, we decline to do so.

39. Complainants assert that the dysfunction in the spot market caused the rates in the specific long-term market-based rate contracts at issue here to be unjust and unreasonable from the outset and, therefore, that the just and reasonable standard of review, rather than the *Mobile-Sierra* public interest standard of review, should apply. "Under these extraordinary circumstances," Complainants argue, "it is error for the Commission to uphold the presumption that the prices in any contract entered during the California energy crisis for delivery in the Western markets by a seller with market-based rate authority are just and reasonable."[69]

40. Because a party who has executed a *Mobile-Sierra* contract cannot avoid its burden to show that a unilaterally proposed change is required by the public interest by claiming that the rates were not just and reasonable when that party executed the contract (unless, e.g., the contract was induced by fraud committed by the seller on the buyer), we reject Complainants' arguments.

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[68] *Northeast Util. Serv. Co., v FERC*, 55 F.3d 686, 689 (1st Cir. 1995).

[69] Complainants' *Reh'g Request* at 68.

41. We also find no merit to Complainants' claims regarding the testimony of Drs. Tabors and Stoft, which, as is clear from the testimony itself as well as from Complainants' January 10, 2003 Post-Hearing Initial Brief, their rehearing request, and other pleadings, were based on forward price curves (forward price curves internally generated by each seller, and the one produced by Navigant Consulting for the buyer). All of these forward price curve models project the various input costs (e.g., the cost of gas, NOx emission allowances) under expected future supply and demand conditions. The resulting forward price curves project the forward spot market prices for delivery of electricity over a period in the future. The sellers argue that they used their forward price curves as a floor and negotiated for higher prices. Meanwhile, Complainants argue that CDWR's own forward curve (and the sellers' internally generated price curves) stood as a ceiling and CDWR negotiated for a lower price.

42. Complainants use the expert testimony to argue that: the forward price curves can appropriately be used to test the justness and reasonableness of the rates under the long term contracts; because the forward curve model used by CDWR incorporated inputs that were not cleansed of market dysfunction, the rates CDWR negotiated were excessive; in late May 2001, the forward and spot prices declined synchronously purportedly proving that high spot prices caused forward prices to be excessive. The sellers disputed all these arguments.

43. Forward price curves are internally generated, proprietary information used by a party for its own

purposes. Each seller and buyer uses its own projections and updates these daily or more often if circumstances change rapidly. Each model is slightly different in its assumptions and therefore will produce different price estimates. While this data is useful for resource planning and contract negotiation purposes, we cannot use that data to judge contract rates. Not only were these forward curve models not designed for that purpose, but the requisite transparency that Commission rate review must have is absent. Moreover, the Commission has never addressed or approved any one particular forward curve model for this purpose, and we find that, even if we could do so, we cannot do so on the record here. Accordingly, we find that it would be inappropriate to rely on the forward price curves and the testimony regarding those curves.

44. Complainants' attempt to use Drs. Pechman's and Ringo's expert testimony to argue that the contracts at issue should be modified because they differ from the advisory benchmark we provided in the December 15, 2000 Order fails as well. Additionally, Snohomish asserts that the Commission arbitrarily and capriciously found that CDWR achieved its central objective in establishing its energy portfolio despite the fact that the average price for the first five years of the terms of the contracts exceeded the advisory benchmark.[70]

45. Complainants refer to our December 15, 2000

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[70] Snohomish *Reh'g Request* at 36.

Order [71] in which we declined to extend the California spot market mitigation measures to forward markets.[72] In that order, we also adopted an advisory benchmark of $74/MWh for five-year contracts for supply around-the-clock to be used as a reference point in addressing any complaints regarding the pricing of contracts negotiated in forward markets. While we expected that the benchmark would be helpful in assessing possible complaints challenging forward prices, we never suggested that a contractual price exceeding the benchmark would be all by itself a sufficient ground for abrogating a contract. Quite to the contrary, we expected that "buyers may elect to negotiate above [the benchmark] to the extent they believe the particular contract or supplier brings value which suits their needs (e.g., shorter term contracts, favorable terms and conditions, assignment of the risk of variable cost exposure, the particular characteristics of the supplier or its resource portfolio, etc.)."[73]

46. Complainants conceded below that the Dynegy, Mirant and Sempra contracts do not lend themselves to comparison with the five-year advisory benchmark. [74] Thus, the benchmark arguments apply only to the Coral contract. To apply

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[71] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv.*, 93 F.E.R.C. ¶ 61,294 (2000) (December 15 Order).

[72] *Id.* at 61,994.

[73] *Id.* at 61,995.

[74] Complainants' January 10, 2003 Post-Hearing Brief at 92, 98, App B p. 27.

the $74/MWh benchmark we set in the December 15 Order for a five-year, supply around-the-clock benchmark to the 11-year Coral contract that does not provide for supply around-the-clock, Complainants' experts used a hybrid analysis.[75] That analysis used the benchmark rate for the first five years of the contract and Coral's segmented forward curve for the remainder of the contract. We never intended such a hybrid approach to be used for benchmark comparisons, and we find that approach unsupported and unacceptable. We already have explained that it would be inappropriate to use a seller's internal forward curve to reach a determination on a contract's rates.

47. Snohomish argues that the Commission's initial review of a seller's market power for purposes of granting market-based rate authority cannot assure that all the rates the seller subsequently charges will be just and reasonable under all circumstances.[76] We agree with Snohomish's position. Indeed, we have recognized that "FPA [Section] 206 complaint procedures apply when it appears that [market-based] rates are no longer just and reasonable."[77] Should a seller acquire market power subsequent to the Commission's acceptance of market-based rates, there is a safeguard that "places sellers on notice that their transactions will

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[75] Exh. CAL-112.

[76] Snohomish *Reh'g Request* at 17, 26-29 (citing *AEP Power Marketing, Inc.*, 97 F.E.R.C. ¶ 61,219 (2001); *Enron Power Marketing, Inc.*, 103 F.E.R.C. ¶ 61,343 (2003); *Enron Power Marketing, Inc.*, 104 F.E.R.C. ¶ 63,010 at P 128 (2003)).

[77] Lockyer at 62,064.

be subject to review and to prospective remedial action, including the possible loss of their market-pricing authorization."[78] Contrary to Snohomish's position, however, this remedial authority does not require contract modification where the contract limits changes to those required by the public interest under *Mobile-Sierra*. As discussed, there has been no showing to support a finding that respondents exercised market power while selling under their market-based pricing authorization with regard to these specific contracts. Thus, there is no reason to move beyond the self-imposed limits on contract changes set by the parties in the challenged contracts. This result is consistent with both our responsibility to assure that market-based rates are just and reasonable and our long-standing respect for the sanctity of private contracts.

48. Snohomish challenges the Commission's determination, based on Borough of Lansdale v. FPC[79] and Richmond Power & Light v. FPC,[80] that *Mobile-Sierra* applies to contracts not on file with the Commission. Contrary to Snohomish's argument, the Commission did not find Lansdale and Richmond to hold that "entities holding market-based rate certificates [are entitled] to charge unjust and unreasonable rates."[81] Instead, as Snohomish itself concedes, the Commission relied on the Lansdale and Richmond cases to demonstrate that a party may not circumvent *Mobile-Sierra*'s

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[78] *Id.* at 62,065.

[79] 494 F.2d 1004, 1113 (D.C. Cir. 1974).

[80] 481 F.2d 490, 497 (D.C. Cir. 1973).

[81] Snohomish *Reh'g Request* at 16-17.

limitations by failing to file a contract with the Commission.[82] The Commission reasoning here was sound.

49. Snohomish further argues that the Commission should have reviewed the contracts at issue under the just and reasonable standard to protect the rights of third parties, especially electric ratepayers. [83]In addition, Snohomish contends that the Commission at the very least should have applied the flexible public interest standard.[84]

50. There is no Commission or court precedent that supports a finding that a non-signatory party may challenge a *Mobile-Sierra* contract under the just and reasonable standard of review, as opposed to the public interest standard of review. The cases cited by Snohomish as dictating application of the just and reasonable standard of review are inapposite. In PJM Interconnection, LLC, [85] the Reliability Assurance Agreement explicitly permitted PJM to submit filings under Section 206 of the FPA. [86] In the instant proceeding, the contracts in question do not contain such a provision.

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[82] *Id.* at 16 (claiming that the cases hold that "utilities do not gain the right, denied them by the *Mobile-Sierra* doctrine, to challenge contract rates as too low simply by failing to comply with the FPA's requirement that all jurisdictional contracts be on file with the Commission.").

[83] Snohomish *Reh'g Request* at 39-40.

[84] Snohomish *Reh'g Request* at 41 (citing Snohomish Brief on Exceptions at 13-15).

[85] PJM Interconnection, LLC, 96 F.E.R.C. ¶ 61,206 (2001).

[86] See id. at 61,878 n.12.

Snohomish also cites to Carolina Power and Light Co.[87] which involved a Commission directive to revise a settlement agreement that had been submitted for Commission acceptance, and not, as in this case, a complaint challenging an existing market-based rate contract for the sale of power. Finally, Snohomish refers to Pennsylvania Electric Co.[88] which speaks in general terms about the Commission's statutory duty to ensure just and reasonable rates. However, the Commission has applied the public interest standard of review to challenges brought by non-contractual parties.[89] In addition, we found no basis for applying a more flexible public interest standard to the contracts at issue. The record shows that the third-party intervenors were not adversely affected by the contract at issue. Similarly, Complainants have failed to show that the contracts at issue imposed an excessive burden on California's ratepayers.

51. Complainants and Snohomish nonetheless assert that the *Mobile-Sierra* public interest standard of review does not apply to the contracts at issue because, purportedly, Complainants are third parties to the contracts as CDWR, rather than the CPUC or CEOB, executed the contracts. As we previously found,[90] however, the State of California, through one of its agents, CDWR, was a party to the contracts. Complainants, like CDWR, are agents of

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[87] Carolina Power and Light Co., 69 F.E.R.C. ¶ 61,078 (1994).

[88] *Pennsylvania Electric Co. v. FERC*, 11 F.3d 207 (D.C. Cir. 1993).

[89] *See, e.g.*, July 23 Order, 100 F.E.R.C. at 61,396.

[90] June 26 Order at P 76.

the State of California, and, therefore, in bringing these complaints, Complainants stepped into the shoes of CDWR as a representative of the State of California. Complainants' own rehearing request supports this conclusion. Throughout the rehearing request, Complainants acknowledge that the buyer under these contracts was the State of California.[91]

52. There also is no merit to Complainants' claim that the Commission's statement in the December 15 Order, that "[t]o address concerns about potentially unjust and unreasonable rates in the long-term markets, we will monitor prices in those markets,"[92] "informed buyers and sellers that the Commission would scrutinize long-term contract rates under a just and reasonable standard."[93] The referenced statement in the December 15 Order did not, and did not intend to, inform any one that unilaterally proposed rate changes to contracts universally would be reviewed under a just and reasonable standard of review. Under *Mobile-Sierra*, unless the parties to a contract reserve their rights to unilaterally propose a rate change, the Commission can grant a unilateral request for a rate

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[91] *See, e.g.*, Complainants' *Reh'g Request* at 48 ("the State of California was forced to step in as the entity responsible for purchasing California's "net short,"); Complainants' *Reh'g Request* at 32 ("it was necessary for the State of California to take the unprecedented step of becoming the buyer for most of the load of the entire state. It did so by authorizing CDWR to purchase the State's 'net short...."); Complainants *Reh'g Request* at 63 ("the State on the public's behalf... enter[ed] the long-term contracts).

[92] December 15 Order, 93 F.E.R.C. at 61,994.

[93] Complainants' *Reh'g Request* at 9.

change only if the proposed change is required by the public interest. We cannot, and did not attempt to, trump the mandates of that long-standing case law.

53. There also is no merit to Complainants' contention that the *Mobile-Sierra* doctrine does not apply to the contracts here because the doctrine is not intended to protect the sanctity of contracts entered into by wrongdoers[94] or the contention that the public interest standard of review is satisfied because "it is against the public interest for sellers to retain the benefits of contracts entered into by virtue of their market-based authority, but which market-based authority they abused." [95] Complainants do not cite to any precedent for these propositions. More importantly, the wrongdoing cited by Complainants involves alleged activities by Mirant and Dynegy in the spot markets, not the forward markets. As mentioned above, we found nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation specific to the long-term contract negotiations resulting in the prices and terms challenged here.[96]

54. In discussing the ALJ's initial decision in the June 26 Order, we stated that she noted that "while the *Mobile-Sierra* doctrine arose in the context of a completely regulated environment, where, as here, the contracts were entered into under the parties'

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[94] *Reh'g Request* at 10-12, 22.

[95] Complainants' *Reh'g Request* at 12.

[96] June 26 Order at P 61.

market-based rate authority, the Commission has stated that '[p]reservation of the contracts has, if anything, become even more critical.' [97] Complainants ask us to explain this statement. As we explained in the April 25 Order:

> The Commission's long-standing policy, consistent with a substantial body of Supreme Court and other judicial precedent, has been to recognize the sanctity of contracts. Rarely has the Commission deviated from that policy, and then only in extreme circumstances, such as the fundamental industry-wide restructuring under Order No. 888 and the reorganization of a bankrupt utility. Preservation of contracts has, if anything, become even more critical since the policy was first adopted. Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are extraordinary circumstances.[98]

55. The critical point is not, however, that sanctity of contracts is even more important in a market-based rate system, but that sanctity of contracts remains vitally important whether the regulatory system is cost-based or market-based.

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[97] *Id.* at P 64 (quoting Partial Initial Decision, 102 F.E.R.C. at P 31 (quoting April 25 Order, 99 F.E.R.C. at 61,383)).

[98] April 25 Order, 99 F.E.R.C. at 61,383 (footnote omitted).

56. Snohomish argues that the *Mobile-Sierra* doctrine applies only in situations where a regulated utility is challenging a contract with a rate it argues is too low.[99] As we stated in the June 26 Order, "[i]n later cases, the *Mobile-Sierra* doctrine was applied to contracts containing rates that allegedly were too high."[100] Snohomish, however, believes that the PSC of New York[101] case the Commission relied on is inapposite.[102] We disagree. The court in PSC of New York held that the *Mobile-Sierra* doctrine protects contracts, not rates; it obligates both buyers and sellers, and the Commission is no more at liberty to alter a contract "to the prejudice of the producers than to do so in their favor."[103] In addition, the *Mobile-Sierra* doctrine has been applied in other cases where a complainant sought to reduce the existing rate.[104]

2. Whether Complainants Met Their Public Interest Burden.

57. Complainants also argue that they have met their public interest burden regarding the contracts at issue. First, Complainants, and Snohomish, assert that the Commission failed to recognize that the three-part Sierra "test" is not the sole measure

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[99] Snohomish *Reh'g Request* at 12.

[100] June 26 Order at P 6.

[101] *Public Service Commission of the State of New York v. FPC*, 543 F.2d 757 (D.C. Cir. 1974) (PSC of New York).

[102] Snohomish *Reh'g Request* at 15-16.

[103] PSC of New York, 543 F.2d at 798.

[104] PEPCO, 210 F.3d 403.

of the public interest standard.[105] This assertion is incorrect. The June 26 Order explicitly found that the Complainants failed to demonstrate any of the three public interest factors addressed in Sierra or any other factors showing that modifying the contracts is required by the public interest.[106] On rehearing, we also have fully considered and addressed all of Complainants' public interest claims. Our discussion of those claims in the June 26 Order and in this Order makes clear that we reject the claims not because we believe we are restricted to considering only the three factors enunciated in Sierra, but because we find the claims do not satisfy Complainants' public interest burden. Thus, we reject this and any other arguments premised on the Commission restricting its consideration of the public interest to the three factors addressed in Sierra because they have no basis in fact. For these same reasons, we reject Snohomish's argument that the Commission ignored every aspect of the public interest outside of the contract negotiations despite evidence of fraud, abuse and manipulative practices.[107]

58. Snohomish argues that the June 26 Order is inconsistent with decisions in French Broad Elec. Membership Corp. v. Carolina Power & Light Co.[108] and Texaco v FERC.[109] In addition, Snohomish

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[105] Complainants' *Reh'g Request* at 13, 15, 64, 65; Snohomish *Reh'g Request* at 32.

[106] June 26 Order at P 8, 39.

[107] Snohomish *Reh'g Request* at 34-35.

[108] 92 F.E.R.C. ¶ 61,283 (2000).

[109] Texaco, 148 F.3d at 1097.

claims that the public interest is met because (1) there is evidence that the bargaining process leading to the execution of the contracts was not the product of a functionally competitive market, and (2) after a period of market dysfunction, the contracts were no longer economical.[110]

59. In the June 26 Order, we determined that Complainants failed to demonstrate that contract modification was required by the public interest.[111] We considered whether Complainants had demonstrated that "any of the three prongs announced in the Sierra case [was] met or that any other factor introduced into evidence warrant[ed] a finding that any of the contracts is contrary to the public interest and should be modified."[112] We found none of the Sierra factors to be present here--whether the rate might impair the ability of the public utility to continue service, cast upon other consumers an excessive burden, or be unduly discriminatory. Moreover, we considered the totality of the circumstances preceding and following the execution of the contracts and found that none justified contract modification.

60. Further, we find Snohomish's reliance on *Atlantic City Elec. Co. v. FERC*,[113] *Northeast Utils. Service Co. v. FERC*,[114] and *Town of Norwood v.*

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[110] Snohomish *Reh'g Request* at 33-34.

[111] June 26 Order at P 3, 8, 39, 60-63.

[112] Id. at P 39.

[113] 295 F.3d 1, 14 (D.C. Cir. 2002), *remanded*, 101 F.E.R.C. ¶ 61,318 (2002), *vacated in part*, 329 F.3d 856 (2003).

[114] 993 F.2d 937, 961 (1st Cir. 1993), *remanded*, 66 F.E.R.C. ¶

FERC[115] to be misplaced. Snohomish's claims that all three demonstrate that the public interest standard of review is met when "there is evidence that the bargaining process leading to the execution of the contracts was not the product of a functionally competitive market." [116] However, Snohomish's reading of the cases is not entirely accurate. All three cases recognize that *Mobile-Sierra* preserves the parties' bargain as reflected in the contract, when there is no need to question what transpired at the contract formation stage.[117] Our decision here is consistent with those cases, as there has been no showing to support a finding of fraud, duress, or the exercise of market power at the contract formation stage.[118]

61. In addition, we reject Snohomish's contention that there are broad policy concerns sufficient to satisfy *Mobile-Sierra*'s public interest standard.[119] There is no policy initiative that would be served by modifying the challenged contracts. The cases on which Snohomish relies involve "extreme

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61,332, *Reh'g denied*, 68 F.E.R.C. ¶ 61,041, *aff'd*, 55 F.3d 686 (1995).

115 587 F.2d 1306, 1313-14 (D.C. Cir. 1978).

116 Snohomish *Reh'g Request* at 33.

117 295 F. 3d at 14; 993 F.2d at 961; 587 F.2d at 1313-14.

118 Contrary to Snohomish's argument, we did not, nor did we intend to "require[] a showing of unfairness, bad faith, or duress" to modify contracts under the public interest standard. Snohomish *Reh'g Request at 37.* In our June 26 Order, we recognized these criterion as three possible grounds to support a public interest finding, but in no way limited our inquiry to these three.

119 Snohomish *Reh'g Request* at 33 & n. 117; 37-38 & n. 137.

circumstances, such as the fundamental industry-wide restructuring under Order No. 888 and the reorganization of a bankrupt utility."[120] Contract modification here is, if anything, contrary to the Commission's policy of respecting contract sanctity and creating the regulatory certainty needed to attract sufficient capital to competitive power markets.

62. Indicated Sellers contend that we erred to the extent we relied in the June 26 Order on extrinsic evidence in determining that the public interest standard of review applies to the contracts at issue. Indicated Sellers seek clarification or rehearing that, unless contractual language preserves rights to make unilateral application to the Commission for changes in rates, the *Mobile-Sierra* public interest standard of review applies. We deny clarification or rehearing on that issue here. Complainants made clear that they "have not argued, or submitted evidence, to the effect that the absence of an explicit *Mobile-Sierra* provision in the [Dynegy and Sempra]

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[120] April 25 Order , 99 F.E.R.C. at 61,383 (citing Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Service by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, F.E.R.C. Stats. & Regs. ¶ 31,036 (1996), *order on Reh'g*, Order No. 888-A, F.E.R.C. Stats. & Regs. ¶ 31,048 (1997), *order on Reh'g*, Order No. 888-B, 81 F.E.R.C. ¶ 61,248 (1997), *order on Reh'g*, Order No. 888-C, 82 F.E.R.C. ¶ 61,046 (1998), *aff'd* in relevant part sub nom. *Transmission Access Policy Study Group, et al. v.* F.E.R.C., 225 F.3d 667 (D.C. Cir. 2000), aff'd sub nom. *New York v. FERC*, 535 U.S. 1 (2002); Northeast Util. Serv. Co., 66 F.E.R.C. ¶ 61,332, *Reh'g denied*, 68 F.E.R.C. ¶ 61,041 (1994)).

contracts is itself a basis for not applying the *Mobile-Sierra* standard to those contracts."[121] Thus, Complainants conceded that "to the extent the *Mobile-Sierra* standard applies to the contracts with explicit *Mobile-Sierra* provisions [the Mirant and Coral contracts], it applies to the contracts without such provisions."[122]

63. Next, Complainants claim that "it is against the public interest for the ultimate consumers to be burdened with contracts that impose unjust and unreasonable rates." [123] In Complainants' view, "[w]hen the subject rates are imposed directly on the public, unjust and unreasonable does mean contrary to the public interest."[124]

64. While Complainants have alleged that the contract rates currently exceed those available in today's markets, that allegation, even if true, does not establish that the contract rates are contrary to the public interest. Our precedent "makes clear that the fact that a contract has become uneconomic to one of the parties does not necessarily render the contract contrary to the public interest." [125]

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[121] *See* Partial Initial Decision at P 44 (quoting Complainants' January 14, 2003 Answer to Motion to Hold Briefing in Abeyance).

[122] *See* Partial Initial Decision at P 44 (quoting Complainants' January 14, 2003 Answer to Motion to Hold Briefing in Abeyance).

[123] Complainants' *Reh'g Request* at 12.

[124] Complainants' *Reh'g Request* at 72; see also Complainants' *Reh'g Request* at 17-18.

[125] PEPCO, 210 F.3d at 409. Snohomish contends that the

Additionally, even if the contract rates at issue will be passed through entirely to ultimate customers, Complainants have failed to show that would be contrary to the public interest.

65. We agree with Complainants that an important public interest is the interest in functioning competitive markets. In this proceeding, however, we have found that the record does not substantiate that the contracts in question caused financial distress for the Complainants (or others they represent), threatening their ability to continue service; that the contracts cast an excessive burden

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Commission erred in relying in its decision on PEPCO in which the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest'] standard." *Id.* at 404. In Snohomish's opinion, PEPCO and the instant case are factually different and thus PEPCO is inapplicable. In deciding whether the Complainants met their burden of proof under the public interest standard of review, we were guided by the court case law developed over several decades. Upon the review of the evidentiary record developed in this proceeding, the findings of the Staff Report, and evidence submitted in the 100-Day Discovery Proceeding, we concluded that the challenged contracts were not contrary to the public interest because the Complainants failed to demonstrate that the contracts in question caused financial distress for the Complainants (or others they represent) so as to threaten their ability to continue service, that the contracts cast an excessive burden on customers, that the contracts were unduly discriminatory to the detriment of other customers that were not parties to this proceeding, or that any other factors on the record of this proceeding demonstrate that the contracts were contrary to the public interest. June 26 Order at P 8.

on customers; that the contracts were unduly discriminatory; or any other factors showing that modifying the contracts is required by the public interest,[126] and we have found nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation specific to the long-term contract negotiations resulting in the prices and terms challenged here.[127] Therefore, we find no merit to Complainants' contentions that our determination that modification of the instant contracts is not required by the public interest allows "market abusers [to] keep the benefits of high rates that their abuses helped bring about"[128] and "effectively declares that as between remedying unjust and unreasonable rates borne by the public itself resulting from circumstances involving seller misconduct...and allowing the same sellers to preserve the benefit of their unfair bargain, the latter is more in the public interest."[129]

66. We also find no merit on the facts here to Complainants' argument that "the Commission should find it is in the public interest to modify contract rates that are 'so high' as to reflect exploitation of the buyer by the seller."[130] We have

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[126] June 26 Order at P 8, 39, 60.

[127] June 26 Order at P 61.

[128] Complainants' *Reh'g Request* at 16.

[129] Complainants' *Reh'g Request* at 22; see also Snohomish *Reh'g Request* at 35 (arguing that the Commission has elevated the interests of regulated utilities above the interests of electric consumers).

[130] Complainants' *Reh'g Request* at 14.

appropriately applied the public interest standard in this proceeding and found that Complainants have not met their burden of proving that the contracts cast an excessive burden on customers.

67. Complainants' contention that the contracts should be modified even if the rates burden customers in some degree less than excessive[131] is similarly inapposite. We have appropriately applied the public interest standard of review in this proceeding and found that Complainants have not met their burden under that standard.

68. We also reject Complainants' argument that our determination that reformation of the instant contracts is not required by the public interest conflicts with our application of the public interest standard of review in El Paso Natural Gas Co.[132] In El Paso, consistent with our holding here, we explained that "only in extraordinary circumstances, and only where the public interest so requires, will the Commission order contract modification. For example, the Commission has ordered contract modification in connection with its restructuring of the natural gas and electric industries."[133] Unlike in El Paso, where we found reformation necessary in the public interest because continued service under the existing contracts would continue the ever

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[131] Complainants' *Reh'g Request* at 14; see also Snohomish *Reh'g Request* at 36.

[132] 99 F.E.R.C. ¶ 61,244 (2002) (El Paso); Complainants' *Reh'g Request* at 16.

[133] El Paso, 99 F.E.R.C. at 62,005 (footnotes listing citations omitted).

increasing degradation to firm service under those contracts contrary to the concept of firm service and our regulations, [134] we have determined that Complainants have not shown that any public interest requires contract modification here.

69. Complainants make a number of arguments challenging our finding that CDWR had options and at least some bargaining power when it entered into the portfolio of contracts at issue here. First, Complainants argue that the available alternatives "were not those that would have been presented in the absence of spot market dysfunction." [135] Complainants' argument is not pertinent here. Complainants were required to meet the public interest standard of review, not the just and reasonable standard of review which could have taken into account the causal connection between the spot market prices and forward bilateral market prices.[136]

70. Moreover, Complainants' claim that "there is no evidence in the record - none- indicating that CDWR could have met the California net short at just and reasonable prices," [137] improperly inverts the burden of proof here. Complainants, as the

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[134] El Paso, 99 F.E.R.C. at 62,003, 62,005-06.

[135] Complainants' *Reh'g Request* at 21.

[136] June 26 Order at P 37.

[137] Complainants' *Reh'g Request* at 20.

proponents of unilateral changes to *Mobile-Sierra* contracts, have the burden to show that the public interest requires contract modification. Thus, no one had the burden to establish that California's net short could have been met at just and reasonable prices.

71. Complainants' assertion that, because sellers had the choice of selling their power into the spot market rather than entering into long-term contracts with CDWR, CDWR lacked bargaining power and had to pay a significant premium to obtain the contracts at issue[138] fails as well. As the experience in California illustrates, sellers who choose to forego entering into long-term power sales contracts assume the risk that spot prices will decrease below the prices they could have obtained in those long-term contracts. Thus, both buyers and sellers have an equal incentive to avoid the price risks innate to spot market sales and to obtain the security long-term contracts provide.

72. Complainants also contend that the fact that CDWR received hundreds of long-term contract offers "does not establish that it had any meaningful bargaining power or that the contract prices were just and reasonable."[139] Our determination that CDWR had bargaining power regarding the contracts at issue was based on our consideration of all the factors discussed in the June 26 Order, not merely on the large number of bids received.

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[138] Complainants' *Reh'g Request* at 49.

[139] Complainants' *Reh'g Request* at 49.

73. Moreover, Complainants claim on the one hand that "[m]any of the bids were mutually exclusive," [140] and, therefore, by definition in competition with each other, while claiming on the other hand that CDWR "[was] not having proposals that were competing against each other."[141] In any event, that many of the bids received were mutually exclusive (or were for less than 100 MWs, or were made by unknown entities with no experience in the power industry)[142] does not negate the myriad other factors we found established California's bargaining power, [143] including that CDWR was able to assemble a portfolio of about 41 contracts for about 12,000 MW during the peak year. [144] And, while Complainants assert that "many of the offers did not start deliveries until after the summer of 2001,"[145] all of the contracts at issue here provided for deliveries during that summer.

74. Complainants' attempt to cast CDWR as lacking bargaining power because, purportedly, the bids received reflected market dysfunction compared to cost-based pricing[146] fails as well. A disparity between market-based and cost-based rates is not sufficient to demonstrate a party's market power or lack of bargaining power.

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[140] Complainants' *Reh'g Request* at 49.

[141] Complanaints' *Reh'g Request* at 51.

[142] Complainants' *Reh'g* Rrequest at 51.

[143] See, e.g., June 26 Order at P 43-59.

[144] June 6 Order at P 49.

[145] Complainants' *Reh'g Request* at 51.

[146] Complainants' *Reh'g Request* at 51

75. Additionally, that CDWR purportedly made certain concessions regarding the terms of certain contracts[147] does not negate that CDWR was able to obtain many concessions from sellers, including obligating many, if not all, of the sellers to: (1) make immediate and/or near-term sales to CDWR at below-market prices, (2) assume transmission and congestion risk and provide high supply availability guarantees, (3) allow CDWR to dispatch the supplier's generation, (4) assume the risk of changes in fuel prices, and (5) provide CDWR the option of choosing seller-supply and/or CDWR-supply of natural gas.[148] In certain contracts, even though the sellers proposed a fuel price indexing formula, CDWR insisted on a fixed price, thereby leaving sellers to bear the risk that fuel prices would increase in the future.[149]

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[147] Complainants' *Reh'g Request* at 51-54, 59-60. Complainants assert that CDWR agreed to a longer term than it wanted in the Sempra contract in order to foster Sempra's construction of new power plants, but that "Sempra claims that the contract does not require it to build any of the plants whose output CDWR was contracting for, and Sempra has aggressively asserted its right, in its sole discretion, to refuse to build such plants and to provide power purchased in the market." Complainants' *Reh'g Request* at 59. That assertion does not reflect on CDWR's bargaining power but involves a contract interpretation dispute that does not belong in this proceeding.

[148] June 26 Order at P 54 (citing Exh. COR-1 at 46:3-47:5; Exh. AYE-14 at 3:1-4:20; Exh. EPME-28 at 10:4-14; Exh. MAEM-1 at 13:5-18; Exh. MSC-1 at 6:16- 7:2; Exh. SER-1 at 25:8-26:21; Exh. DYN-1 at 26:15-27:3).

[149] *Id.* (citing Exh. S-1 at 25:8-11).

76. Complainants protest that CDWR's ability to contract for energy in 2001 at below market prices does not indicate that CDWR had bargaining power because "each of the contracts was priced above the then existing market forward price curve such that any below-market sales in 2001 were more than made up over the life of the contract." [150] That protest, like Complainants' earlier argument, inappropriately compares internally generated forward price curves to contract rates in an attempt to show that the contract rates are unjust and unreasonable or contrary to the public interest. As we explained above, internally generated forward price curves cannot be used to judge contract rates. For the same reasons, they cannot be used to show lack of bargaining power. Even if Complainants' assumption were correct, however, that does not diminish that CDWR was able to bargain and contract for energy at below market prices in the immediate and/or near term, when energy was critically needed.

77. Complainants assert that CDWR did not want ten-year contracts but wanted contracts with terms of one to three years. That assertion is belied, however, by the fact that CDWR's second request for bids did not indicate a preference for any particular contract term.[151]

78. And, while Complainants assert that CDWR

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[150] Complainants' *Reh'g Request* at 59.

[151] June 26 Order at P 48.

did not achieve its purported goal of one-to-three year contracts with an average price of $70/MWh, CDWR did achieve a central objective of obtaining a portfolio of contracts that yielded a weighted average price no higher than $70/MWh, the average cost of energy supply reflected in the IOUs' retail rates as of January 2001.[152] That CDWR may not have obtained the exact bargain it had in mind does not establish that it lacked bargaining power. Rather, it simply shows that the give-and-take innate to negotiation occurred.

79. Complainants also argue that the Commission erred in stating in the June 26 Order that "Complainants benefited from resales of the energy purchased under these contracts during the relevant period"[153] because, in Complainants' view, "there is no evidence in the record (and the Commission cites none) that Complainants (or even CDWR) benefited from the power sales."[154] In stating that "Complainants benefited from resales of the energy purchased under these contracts during the relevant period," we meant only that California benefited by entering into the contracts at issue because California was able to resell the power obtained under the contracts to meet California's energy needs. The record certainly supports that finding.[155]

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[152] June 26 Order at P 40.

[153] June 26 Order at P 8.

[154] Complainants' *Reh'g Request* at 21.

[155] Complainants' own rehearing request states that CDWR sought this outcome. Complainants' *Reh'g Request* at 49 (stating that CDWR chose to "purchase the electricity

80. We also find no merit to Complainants' argument that the dysfunction in the spot markets, the California Power Exchange ceasing operations and declaring bankruptcy, the bankruptcy and near-bankruptcy of two California investor owned utilities, and California "tak[ing] the unprecedented step of becoming the buyer for most of the load for the entire state," constitute extraordinary circumstances that satisfy the *Mobile-Sierra* standard.[156] Complainants have not shown that, on balance, the prices in the challenged contracts harmed the public interest as envisioned in *Mobile-Sierra*.

81. Nor are Complainants correct that we did not consider the totality of the circumstances. In both the June 26 Order and here, we have considered the totality of the circumstances surrounding these contracts, including the California energy crisis and related events. Complainants have failed to establish, however, that any of those circumstances caused the contracts at issue to be contrary to the public interest.

82. Complainants' next contention, that the instant contracts "burden consumers with forward prices 33-60% in excess of a just and reasonable price," which constitutes an extraordinary circumstance satisfying the *Mobile-Sierra*

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through long-term contracts and thereby reduce the reliance on the spot market and obtain a reliable supply at lower immediate cost.")

[156] Complainants' *Reh'g Request* at 32.

standard,[157] fails as well. Complainants do not cite the basis for their 33-60% figure, and we know of none in this record. Furthermore, we have found that the Complainants failed to demonstrate that the contracts in question cast an excessive burden on customers.[158]

83. While Complainants argue that they demonstrated that the contracts were priced above long-run competitive prices, they base that claim on the testimony and evidence presented by Drs. Tabors and Stoft. We have found that testimony and evidence to be based on forward price curves that cannot appropriately be used for such a comparison. Complainants' other asserted evidence, the Staff Report, did not, contrary to Complainants' assertion, "find [] that forward prices in the 1-2 year class of contracts [were] unjust and unreasonable as a result of spot market dysfunction."[159] The Staff Report did not make any findings regarding the justness and reasonableness of any contract rates and any such findings would not be relevant here because the just and reasonable standard is not applicable.

84. Complainants' effort to diminish the impact of the fact that CDWR assembled a highly sophisticated procurement team to assist in its contracting decisions is unavailing. The procurement team's sophistication is part of the totality of the circumstances that informs our analysis of the public interest regarding the

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[157] Complainants' *Reh'g Request* at 32.

[158] June 26 Order at P 8, 39, 60.

[159] Complainants' *Reh'g Request* at 42.

contracts in this case.

85. Despite Complainants' claims to the contrary, [160] comments by the California officials indicating that they fully supported the price, terms and conditions made contemporaneous with the contracts' execution are relevant, along with all other factors, to our determination of whether the instant contracts should be modified under the FPA. For example, a memorandum prepared by a member of California's negotiating team stating that "[e]ach power purchase agreement was the subject of often protracted negotiations. Frequently, sellers had to concede numerous points to obtain the terms and provisions they ultimately ended up with in the agreements,"[161] confirms that numerous concessions were made by sellers to obtain the contracts. Similarly, CDWR's lead negotiator's statement that "I can't get terribly upset by these critics who say oh, by gosh, this is higher than what the price might be. Well, hell, they don't know. We didn't just fall off a turnip truck. I am not saying we took the shirt off their back. But I am saying that these were fair, negotiated, hard-fought deals,"[162] corroborates that California's contracting team was sophisticated and engaged in fair and real negotiations.

86. Complainants' claim that they demonstrated bad faith, unfairness and duress by the respondents, proffering the "evidence in the Final Staff Report

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[160] Complainants' *Reh'g Request* at 56-57.

[161] June 26 Order at P 50 (citing Exh. AYE-51 at NAV08-016238; Tr. at 1561:14-1562:18).

[162] *Id.* (citing Exh. DYN-26 at 152:16-153:8).

and 100-day submissions that the entire California energy crisis was caused in large part by the rampant and widespread market manipulation by numerous sellers, which led to the insolvency of the IOUs and in turn forced the California public to enter the long term contracts through CDWR in order to avoid continued blackouts and stage 3 alerts." [163] Complainants' proffer does not suffice because, even if true, it does not show bad faith, unfairness or duress by any seller in the original negotiations of the contracts at issue as is required. Furthermore, the record evidence demonstrates that market fundamentals such as increased demand, reduced generation and increased fuel costs were variables that contributed significantly to the escalation in market prices.[164]

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[163] Complainants' *Reh'g Request* at 63-64.

[164] Exh. MSC-7 at 5:15-6:3; MSC-7 at 8:12-9:12; Exh. AYE-1 at 13:1-9; Exh. MSC-7 at 11:20-12:4; Exh. MSC-7 at 9:15-10:6; Exh. MSC-7 at 10:7-12; Exh. MSC-7 at 11:6-9; Exh. COR-25 at 12:4-9; Exh. MSC-7 at 11:19-20; Exh. EPME-1 at 18:15- 17; Exh. COR-25 at 11:6-13, 12:7; Exh. COR-25 at 18:12-22; Exh. EPME-1 at 28:13-15; Exh. COR-25 at 12:16; Exh. EPME-1 at 16:8-17:3; Exh. EPME-1 at 40:15- 41:1; Exh. EPME-14A; Exh. EPME-1 at 21:6-11; Exh. MSC-7 at 59:3-16; Exh. COR-25 at 22:1-3; Exh. EPME-1 at 45:8-14; Tr. at 835:20-836:4; Exh. MSC-7 at 19:2-9; Exh. MSC-7 at 19:11-13; Exh. COR-25 at 15:16-17; Exh. EPME-1 at 18:5-14; Exh. EPME-3; Exh. COR-25 at 15:16-23; Exh. MSC-7 at 28:12-29:2; Exh. MSC-7 at 19:14- 17; Exh. COR-25 at 23:19-24:6; Tr. at 839:8-9; Exh. COR-25 at 14:2-4; Exh. AYE/SER-1 at 16:7-15; Exh. AYE-1 at 17:3-10; Exh. MSC-7 at 37:15-16; Exh. COR-25 at 11:6-13, 14:6-25; Exh. MSC-7 at 41:6-12; Exh. MSC-7 at 43:10-13; Exh. COR-25 at 23:12-18; Exh.MSC-7 at 39:5-10; Tr. at 838:20-25; Exh. EPME-1 at 22:5-11; Exh. MSC-7 at 31:8-13, 31:16-20; Exh. MSC-7 at 33:8-16; Exh. EPME-56 at 1:11-18; Exh. COR-48 at 12:15-17; Exh. EPME-1 at 21:9-22:2; San Diego Gas &

87. Snohomish argues that the June 26 Order suggests two contradictory tests for meeting the burden of proof under the public interest standard of review. According to Snohomish, these tests are the Sierra three-prong test and the requirement to show market manipulation specific to the contracts at issue, as well as "unfairness, bad faith, or duress during the original negotiations." [165] In the alternative, Snohomish argues that the contracts were the product of market manipulation.

88. We disagree. In the June 26 Order, we did not create two different public interest tests. Our statement that "there [was] nothing in the record, in the Staff Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation specific to the long-term contract negotiations resulting in prices and terms being challenged here" [166] was in response to the Complainants' contention that contract modification is warranted based on the Staff Report findings and the 100-Day Discovery Proceeding allegations of manipulation in the spot market. We reviewed the Staff Report findings and evidence submitted in the 100-Day Discovery Proceeding and found no

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Electric Co. v. Sellers of Energy and Ancillary Serv., 93 F.E.R.C. ¶ 61,121 at 61,354-55, 61,358-59; Exh. S-2 at 7:6-17, 17:9-14. See also Oral Argument Transcript at 12:17-19 (May 15, 2003) ("We have recognized in our proceeding throughout, that there were underlying market fundamentals at work that created tight markets in California.").

[165] Snohomish *Reh'g Request* at 32-33, 37.

[166] June 26 Order at 61.

evidence supporting a finding of market manipulation that specifically affected the contracts at issue.

89. Snohomish also challenges the Commission's finding that "because there is no evidence of unfairness, bad faith, or duress in the original negotiations, Complainants are not entitled to change CDWR's bargains."[167] Snohomish contends that the showing of unfairness, bad faith, or duress is not required to meet the public interest standard of review.

90. We disagree. In the April 25 Order, we instructed the ALJ to consider and the parties to submit evidence on "the totality of purchases and sales and the conditions present at the time the contracts were entered into."[168] As we stated in the July 23 Order, the instructions were tailored to "assist the judge in focusing on the main issue that the hearing is intended to resolve."[169] Whereas "unfairness, bad faith, or duress in the original negotiations" were not explicitly mentioned, such evidence could be relevant to the conditions present at the time of contract formation and whether the Commission should uphold or modify the challenged contracts. Moreover, as we stated in the July 23 Order, the list of evidentiary requirements was not exclusive; the parties were free to offer other evidence deemed by the ALJ to be relevant to the

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[167] June 26 Order at 62; Snohomish *Reh'g Request* at 37.

[168] April 25 Order, 99 F.E.R.C. at 61,384.

[169] July 23 Order, 100 F.E.R.C. at P 14.

Commission-prescribed scope of the hearing.[170]

91. Furthermore, as Snohomish acknowledges in its rehearing request, the three-part Sierra "test" is illustrative and other factors can be considered.[171] We believe that a showing of fraud, duress, or bad faith between the parties at the contract formation stage could be an alternative ground for modifying the challenged contracts. Our review of a broader range of evidence concerning the circumstances surrounding formation of the contracts at issue imposed no harm on the Complainants. However, the Complainants failed to make this showing; they also failed to meet the Sierra three-prong test or demonstrate that contract modification is justified based on the totality of circumstances. [172] On rehearing, we also have fully considered and addressed all of Complainants' public interest claims. Our discussion of those claims in the June 26 Order and in this Order makes clear that we reject the claims because we find the claims do not satisfy Complainants' public interest burden.

92. Complainants also argue that the contracts should be modified because the requested remedy would allow every seller to recover all its legitimate costs, plus a reasonable rate of return, and that, in the extraordinary circumstances here, that remedy would not create precedent that would impede

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[170] *Id.*

[171] Snohomish *Reh'g Request* at 32-34.

[172] June 26 Order at P 8, 39, 60-63.

contract formation in the normal course. We cannot subvert the mandates of the *Mobile-Sierra* doctrine, however, absent demonstrated harm to the public interest. Complainants have not satisfied that burden here.

93. Complainants claim that the instant contracts must be modified to correct a lack of confidence in competitive markets caused by the energy crisis in California. Even assuming there is a lack of confidence in competitive markets caused by the energy crisis in California, Complainants are merely speculating, without making a supportive showing, that modifying the long-term contracts here would cure it. We find no basis for Complainants' speculative claim.

94. Next, Complainants and Snohomish assert that it is inconsistent and a disincentive for buyers to enter into future long-term contracts for the Commission to order refunds of unjust and unreasonable spot market rates but to deny modification of the contracts here. In making this assertion, Complainants ignore that these spot market sales are not subject to the mandates of the *Mobile-Sierra* doctrine, while the long-term forward contracts at issue here are. Thus, while we are bound by a public interest standard in reviewing the complaint here, we are bound only by a just and reasonable standard in reviewing the California spot market sales. They also ignore that buyers can retain their rights to unilaterally file for rate changes under the just and reasonable standard by including a provision to that effect in their contracts. The latter fact also critically undermines Complainants' contention that the *Mobile-Sierra*

doctrine can be construed as providing a disincentive for long-term contracting.

95. While Complainants protest that we have held them to an inappropriate burden of proof, contending that they only had to come forward with a prima facie case, the law is clear that the proponent of a unilateral change to a *Mobile-Sierra* contract has the burden to show that the public interest requires that change. [173] We held Complainants to the appropriate burden of proof here. For this same reason, we reject Snohomish's argument that the burden of proof required in proceedings under Section 205 of the FPA is applicable here.[174]

96. In the background section of the June 26 Order, we noted that, in an April 25 Order,[175] we dismissed the complaints as to contracts entered into after June 20, 2001, the date on which our West-wide mitigation went into effect.[176] California (by Complainants CEOB and the California Public Utilities Commission) sought but was denied rehearing on that issue in the July 23 Order.[177] Complainants' renewal here of their objection to our holding in the April 25 and July 23 Orders is an improper collateral attack on those orders and is, therefore, dismissed.

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[173] Texaco, 148 F.3d at 1096-97.

[174] Snohomish *Reh'g Request* at 30-31.

[175] April 25 Order, 99 F.E.R.C. at 61,383-84.

[176] June 26 Order at P 11.

[177] July 23 Order, 100 F.E.R.C. ¶ 61,098.

97. Complainants are concerned that in the June 26 Order we did not address matters it raised that were set out in Appendix C of that order. In the June 26 Order, however, we considered those arguments and found them unpersuasive. Moreover, in this Order, we again have considered and discussed Complainants' arguments set out in Appendix C of the June 26 Order.

98. On rehearing, Complainants raise, for the first time, the argument that the ALJ erred by excluding the testimony of Stephen Sorey. [178] Complainants do not explain why they waited until after the June 26 Order was issued to raise for the first time on rehearing such a fundamental issue. The Commission generally looks with disfavor on parties raising on rehearing issues that should have been raised earlier.[179] Such behavior is disruptive to the administrative process because it has the effect of moving the target for parties seeking a final administrative decision. Absent good cause, not present here, we will not consider Complainants' new argument raised for the first time on rehearing. Furthermore, since Complainants did not except to the ALJ's evidentiary ruling, its objections were technically waived under Rule 711(d)(2) of the

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[178] Complainants' *Reh'g Request* at 25.

[179] *Tenaska Power Services Co. v. Southwest Power Pool, Inc.*, 102 F.E.R.C. ¶ 61,140 at P 14 (2003) (citing *Baltimore Gas & Electric Company, et al.*, 91 F.E.R.C. ¶ 61,270 at 61,922 (2000); *Northern States Power Company (Minnesota), et al.*, 64 F.E.R.C. ¶ 61,172 at 62,522 (1993); *Cities and Villages of Albany and Hanover, Illinois, et al.*, 61 F.E.R.C. ¶ 61,362 at 62,451 (1992)). See also Rule 711(d)(2).

Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.711(d)(2) (2003).

99. Moreover, even if we were to consider Complainants' new argument, we affirm the ALJ's ruling that this testimony was outside the scope of the proceeding because it related to a Sacramento Municipal Utility District long-term contract with Duke Energy Trading & Marketing, LLC not at issue here and thus should be stricken. [180] Furthermore, even if this evidence were included in the record, it would not change our decision. Complainants state that "Mr. Sorey testified that market participants at the time knew the spot market prices were inflated by dysfunction, expected such dysfunction to continue indefinitely, and specifically did not expect that the Commission's December 15 Order would eliminate the effects of such dysfunction."[181] These statements address the issue of whether there was dysfunction in the spot market, a fact not at issue in this proceeding. Therefore, it is not pertinent to our decision.

100. Complainants reassert their objection to the ALJ's exclusion of evidence of market manipulation.[182] We reiterate our finding that the ALJ properly interpreted the Commission orders on this issue and appropriately ruled to exclude the

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[180] *See* Transcript of Prehearing Conference at 331:6-22 (Oct. 30, 2002).

[181] Complainants' *Reh'g Request* at 25.

[182] Complainants' *Reh'g Request* at 25-26, 33-34.

evidence. [183] Additionally, Complainants had the opportunity to present evidence adduced in the 100-Day Discovery Proceeding [184] (California, by its Attorney General, and Complainants CEOB and the CPUC participated in the discovery process and submitted evidence in that proceeding) in which we allowed parties to conduct broad discovery into market manipulation during the western power crisis of 2000 and 2001. Contrary to Complainants' and Snohomish's assertions,[185] Complainants had a full opportunity in the 100-Day Discovery Proceeding to conduct the discovery they complain they did not have an opportunity to discover here. We note that, while Complainants have only generally proffered the evidence submitted in that proceeding without pointing to or discussing any particular evidence for our consideration, in making our determination here we considered all of the evidence submitted in that proceeding.

101. After carefully considering all of the evidence submitted by Complainants in this proceeding, the Staff Report,[186] and the evidence submitted in the

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[183] June 26 Order at P 24.

[184] *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Serv.*, 101 F.E.R.C. ¶ 61,186 (2002).

[185] Complainant's *Reh'g Request* at 4, 34, 37, 61-62; Snohomish *Reh'g Request* at 37-38.

[186] Complainants assert that we erred in acting on their complaints before Commission Staff completes its investigation into alleged market power and withholding by sellers. We find otherwise. This complaint proceeding is separate from the staff investigation. Nothing has been presented to show that it is necessary to hold our decision regarding the instant complaints until the separate staff

100-Day Discovery Proceeding, we found that Complainants did not sustain their burden under the public interest standard to justify the modification of these contracts.

102. There also is no merit to Complainants' claim that the June 26 Order is inconsistent with the April 25 Order. Complainants argue that in the April 25 Order "the Commission asked whether expectations of future dysfunctional prices inflated forward expectations so that the spot market dysfunctions could be said to have adversely impacted forward market prices, invalidating those prices." [187] They contend that "[c]onfronted with such evidence now, the Commission draws the conclusion that such evidence somehow validates the unjust and unreasonable forward prices." [188] Complainants' statement of our holding is incorrect. In the June 26 Order, we applied the public interest standard of review and found that Complainants did not meet their burden to justify modification of these contracts. Furthermore, in the June 26 Order, we explained that the causal effect of the spot market on forward bilateral prices would be relevant to contract modification only where the just and reasonable standard of review is applied. [189] Since the just and reasonable standard of review is not applicable here, that issue was not pertinent to our findings. Nothing in our determinations conflicts with our April 25 Order.

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investigation is completed.

[187] Complainants' *Reh'g Request* at 27.

[188] *Id.*

[189] June 26 Order at P 37.

103. Complainants assert that, since they were wrongly prohibited from conducting any discovery concerning market manipulation and abuse, it is erroneous to exclude the evidence adduced in Docket Nos. EL01-10, IN01-3, EL02-113-000, EL02-114-000, EL02-115-000, EL02-80, EL02-81, EL02-82 and EL02-83 from the record in these proceedings. The Commission may reopen the record in its discretion where there is good cause.[190] The Commission views good cause as consisting of extraordinary circumstances, that is, a change in circumstances that is more than just material, but goes to the very heart of the case.[191] In deciding whether to exercise its discretion, "the Commission looks to whether or not the movant has demonstrated the existence of extraordinary circumstances that outweigh the need for finality in the administrative process."[192] As the Commission explained in Opinion No. 238, "we recognize of course that changes have occurred since the close of the record. But such changes always occur. Yet litigation must come to an end at some point. Hence the general rule is that the record once closed will not be reopened."[193]

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[190] 18 C.F.R. § 385.716 (2003).

[191] CMS Midland, Inc., 56 F.E.R.C. ¶ 61,177 at 61,624, *Reh'g* denied, 56 F.E.R.C. ¶ 61,361 (1991).

[192] *East Texas Electric Coop., Inc. v. Central and South West Serv.*, Inc., 94 F.E.R.C. ¶ 61,218 at 61,801 (2001) (denying reopening of record where movant sought to use actual data which became available after the close of the record in place of hypothetical data used at hearing).

[193] Transwestern Pipeline Co., Opinion No. 238, 32 F.E.R.C. ¶ 61,009 (1985), *Reh'g denied*, Opinion No. 238-A, 36 F.E.R.C. ¶ 61,175 at 61,453 (1986).

104. Contrary to Complainants' assertion, Complainants had a full opportunity in the 100-Day Discovery Proceeding to conduct the discovery into market manipulation during the western power crisis of 2000 and 2001 that they complain they did not have an opportunity to discover here. In the June 26 Order, the Commission found that the records of those other proceedings contain thousands of submittals, most of which are case-specific and not relevant to the issues in the instant proceeding and that the documents that could be relevant have been submitted in the 100-Day Discovery Proceeding.[194] The evidence that Complainants seek to introduce into the record will not change the outcome of this proceeding; therefore, we reject Complainants' argument.

The Commission orders:

(A) The Complainants' and Snohomish's requests for rehearing of the June 26 Order are hereby denied for the reasons stated in the body of this order.

(B) The Indicated Sellers' request for clarification of the June 26 Order is hereby granted in part and denied in part for the reasons stated in the body of this order.

(C) CARE's request for rehearing of the June 26 Order is hereby denied for the reasons stated in the body of this order.

(D) The Complainants' motion to dismiss the

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[194] June 26 Order at P 34.

complainants in Docket Nos. EL02-60 and EL02-62 with prejudice as to El Paso is granted, as discussed in the body of this order.

By the Commission. Commissioner Massey dissenting with a separate statement attached. Commissioner Brownell concurring with a separate statement attached.

(S E A L)

s/ Linda Mitry
Linda Mitry
Acting Secretary.

FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, and Nora Mead Brownell.

Public Utilities Commission of the State of California

Docket Nos. EL02-60-000
v. EL02-60-003
EL02-60-004

Sellers of Long Term Contracts to the California Department of Water Resources

California Electricity Oversight Board

Docket Nos. EL02-62-000
v. EL02-62-003
EL02-62-004

Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources (Consolidated)

(Issued November 10, 2003)

MASSEY, Commissioner, *dissenting*:

I dissented from the underlying order and nothing in today's order persuades me to change my mind. The public interest requires that the contracts at issue be reformed.

For the reasons stated in my dissent in the underlying order, I dissent from today's order.

s/ William L. Massey
William L. Massey
Commissioner

FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the State of California

Docket Nos. EL02-60-000
v. EL02-60-003
EL02-60-004

Sellers of Long Term Contracts to the California Department of Water Resources

California Electricity Oversight Board

Docket Nos. EL02-62-000
v. EL02-62-003
EL02-62-004

Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources (Consolidated)

(Issued November 10, 2003)

Nora Mead BROWNELL, *Commissioner concurring*:

1. I am writing separately to reiterate a concern I raised about the June 26 Order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the contracts' failure to

explicitly reserve the buyer's right to seek unilateral changes under Section 206.[195] Nevertheless, I was willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[196]

2. This order could have simply affirmed the ALJ's conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do. Unfortunately, today's order fails to do so and instead bases the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The *Mobile-Sierra* doctrine is not an invention of the FERC that

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[195] *Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al.*, 99 F.E.R.C. ¶ 61,087 (2002) (citing *Texaco Inc. v. FERC*, 148 F.3d 1091, 1096 (D.C. Cir. 1998) and *Boston Edison Co. v. FERC*, 233 F.3d 60, 67 (1st Cir. 2000)).

[196] *Public Utilities Commission of the State of California v. Sellers of Long-Term Contracts to the California Department of Water Resources, et al.*, 102 F.E.R.C. ¶ 63,013 at P 28 (2003); *Nevada Power Company and Sierra Pacific Power Company v. Duke Energy Trading and Marketing, L.L.C., et al.*, 101 F.E.R.C. ¶ 63,031 at P 27 (2002); and *PacifiCorp v. Reliant Energy Services, Inc., et al.*, 102 F.E.R.C. ¶ 63,030 at P 18 (2003).

we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the parties' intent in future contract abrogation cases.

s/ Nora Mead Brownell
Nora Mead Brownell

APPENDIX S

105 FERC ¶ 61,185

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and
Nora Mead Brownell.

Nevada Power Company
and Sierra Pacific Power Company

Docket Nos. EL02-28-00
EL02-28-005
EL02-33-004

v.

EL02-33-005
EL02-38-004
EL02-38-005

Enron Power Marketing, Inc.
El Paso Merchant Energy
American Electric Power Services, Corp.

Nevada Power Company

Docket Nos. EL02-29-004
EL02-29-005

v.

EL02-30-004
EL02-30-005

	EL02-31-004
Reliant Energy Services	EL02-31-005
Energy Marketing, L.P.	EL02-32-004
Mirant Americas	EL02-32-005
Calpine Energy Services	EL02-34-004
Morgan Stanley Capital Group	EL02-34-005
BP Energy Company	EL02-39-004
Allegheny Energy	EL02-39-005
Supply Company, L.L.C.	

Southern California Water Company

Docket Nos. EL02-43-004
v. EL02-43-005

Mirant Americas Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

Docket Nos. EL02-56-004
v. EL02-56-005

Morgan Stanley Capital Group, Inc.

(Consolidated)

ORDER ON REQUESTS FOR REHEARING AND CLARIFICATION

(Issued November 10, 2003)

1. In this order, we address requests for rehearing and clarification of our June 26, 2003

Order[1] in which we affirmed the Initial Decision[2] by the Administrative Law Judge (ALJ) denying complaints filed by Nevada Power Company and Sierra Pacific Power Company (Nevada Power and Sierra Pacific or collectively, Nevada Companies), Southern California Water Company (SCWC), and Public Utility District No. 1 Snohomish County, Washington (Snohomish). The complaints alleged that dysfunctions in the California electricity spot markets caused forward contracts negotiated in the bilateral markets in California, Washington and Nevada, and entered into pursuant to the Western Systems Power Pool (WSPP) Agreement during the period November 1, 2000 through June 20, 2001, to be unjust and unreasonable. The complaints sought a remedy of contract modification. In this order, we deny the requests for rehearing and we reaffirm our conclusion that the record in this proceeding does not support modification of the contracts at issue for the reasons stated below; and address the request for clarification.

2. In addition, we will address a request for rehearing of the order issued on April 23, 2003[3] in response to a motion filed by SCWC and Snohomish in which they requested that the Commission

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[1] Nevada Power Co. & Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, *et al.*, *et al.*, 103 F.E.R.C. ¶ 61,353 (2003), *reh'g pending*. (June 26 Order).

[2] Nevada Power Co. & Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, 101 F.E.R.C. ¶ 63,031 (2002) (Initial Decision).

[3] Nevada Power Co. & Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, F.E.R.C. ¶ 61,080 (2003), *reh'g pending*. (April 23 Order).

disclose alleged prohibited off-the-record communications during a March 26, 2003 press conference attended by three commissioners and a conference call the same day between two commissioners and a group of Wall Street analysts. In this order, we deny the requests for rehearing of the April 23 Order for the reasons stated below.

3. This order is in the public interest because it balances effective rate regulation with respect for the sanctity of contracts, as dictated by the U.S. Supreme Court under the *Mobile-Sierra* doctrine.

Background

4. In December 2001, Nevada Companies filed separate complaints against the following entities: Duke Energy Trading and Marketing, L.L.C. (Duke), Morgan Stanley Capital Group Inc. (Morgan Stanley), Calpine Energy Services, L.P. (Calpine), Mirant Americas Energy Marketing, L.P. (Mirant), Reliant Energy Services, Inc. (Reliant), El Paso Merchant Energy, L.P. (El Paso), BP Energy Company (BP), American Electric Power Service Corporation (AEP), Enron Power Marketing Inc. (Enron), and Allegheny Energy Supply Company, L.L.C. (Allegheny). SCWC filed a complaint against Mirant. In February 2002, Snohomish filed a complaint against Morgan Stanley. The Nevada Companies and SCWC argued that the dysfunctions in the Power Exchange (PX) and Independent System Operator (ISO) spot markets caused long-term contracts negotiated in California, Washington, and Nevada to be unjust and unreasonable and, consequently, requested modification of their contracts. Snohomish argued that the term of its

contract and the Collateral Annex[4] were unjust and unreasonable. Unlike Nevada Companies and SCWC, Snohomish requested modification of the contract term, not the contract rate.

5. On January 10, 2002, Nevada Companies filed a notice of withdrawal with prejudice of complaint against Duke, explaining that Nevada Companies and Duke reached an agreement to modify their contracts, effective June 4, 2002.

6. On April 11, 2002, the Commission issued an order setting the instant complaints for a trial-type evidentiary hearing.[5] In the April 11 Order, the Commission instructed the ALJ to examine the following issues: (1) whether the challenged contracts should be reviewed under the just and reasonable standard or the more stringent public interest standard of review; and (2) whether the dysfunctional California ISO and PX spot markets adversely affected Western long-term bilateral markets, and if so, whether contract modification is warranted.

7. The hearing on these issues was held from October 7-24, 2002. The Initial Decision was issued on December 19, 2002. In the Initial Decision, the ALJ found that the *Mobile-Sierra* public interest

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[4] The Collateral Annex sets forth the conditions under which Snohomish is required to provide collateral, as well as the conditions under which Morgan Stanley will release such collateral.

[5] Nevada Power Co. & Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, , 99 F.E.R.C. ¶ 61,047, *order on reh'g*, 100 F.E.R.C. ¶ 61,273 (2002), *reh'g pending*. (April 11 Order).

standard of review[6] applies to the contracts at issue. Furthermore, the ALJ concluded that Complainants failed to satisfy their burden of proof to justify contract modification under the public interest standard.

8. On November 20, 2002, the Commission issued an order allowing parties in the Docket No. EL00-95, et al. proceeding to adduce evidence that was either indicative or counter-indicative of market manipulation that may have occurred during the California energy crisis of 2000-2001 (100-Day Discovery Proceeding).[7] The submission of evidence in the 100-Day Discovery Proceeding was completed on March 20, 2003.

9. On March 26, 2003, the Commission released the Commission Staff's Final Report on Price Manipulation in Western Markets in Docket No. PA02-2-000 (Staff Report). The Staff Report, among other things, asserted that many spot market trading strategies undertaken by certain sellers were in violation of anti-gaming provisions of the Commission-approved tariffs for the California ISO and PX. Upon Staff's recommendation, the Commission issued certain "show cause" orders requiring the named market participants to respond to market manipulation allegations of the Staff

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[6] *See* United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) (Mobile); FPC v. Sierra Pac. Power, 350 U.S. 348 (1956) (Sierra); and United Gas Pipe Line Co. v. Memphis Light, Gas &Water Div., 358 U.S. 103 (1958).

[7] San Diego Gas & Electric Co. v. Sellers of Energy & Ancillary Serv., 101 F.E.R.C. ¶ 61,186 (2002), *order on clarification and reh'g*, 102 F.E.R.C. ¶ 61,164 (2003).

Report. Additionally, the Staff Report addressed the issue of whether the dysfunctional spot market had an impact on the forward prices reflected in long-term power supply contracts. The Staff Report analysis found that spot prices influenced forward prices negotiated during the January 1, 2000 through June 21, 2001 crisis period and that the influence was the greatest for contracts with one to two years terms.

10. On June 26, 2003, the Commission issued an order affirming the Initial Decision denying the complaints. In denying the instant complaints, the Commission took into consideration the evidentiary record developed in the instant proceeding, findings of the Staff Report, and evidence submitted in the 100-Day Discovery Proceeding. Specifically, the Commission affirmed the Presiding Judge's findings that the applicable standard of review for the contracts at issue was the public interest standard and that the Complainants failed to meet their burden of proof under this standard of review.

11. Furthermore, based on the review of the evidence and the totality of circumstances, the Commission concluded that the Complainants failed to meet their burden of proof under the public interest standard, as defined in past cases. The Commission found that the challenged contracts were not contrary to the public interest because the Complainants failed to demonstrate that the contracts in question caused financial distress for the Complainants so as to threaten their ability to continue service, that the contracts cast an excessive burden on their customers, that the contracts were unduly discriminatory to the detriment of other

customers that are not parties to this proceeding, or that any other factors on this record demonstrate that the contracts were contrary to the public interest. The Commission also noted that:

> ... at the time of contract execution, other alternatives were available to the Complainants; however, they chose to enter into the contracts in question, accepting market risks. Complainants benefited from resales of the energy purchased under these contracts during the relevant period; however, after the drop in prices in mid-2001, Complainants became dissatisfied with their bargains and sought contract modification. The law is quite clear on that point. The fact that a contract becomes uneconomic over time does not render it contrary to the public interest.[8]

12. The following parties filed timely requests for rehearing of the June 26 Order: SCWC, the Public Utilities Commission of Nevada (NPUC), the Office of the Attorney General of the State of Nevada, Bureau of Consumer Protection (NBCP), Nevada Companies, and Snohomish. Allegheny, BP, Calpine, El Paso, Enron, Mirant and Morgan Stanley (collectively, Respondents) also filed a limited request for clarification.

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[8] *See* June 26 Order at 62,384.

Discussion

Applicable Standard of Review

13. Complainants, NBCP, and NPUC argue that in the June 26 Order, the Commission violated its statutory obligation to ensure just and reasonable rates when it determined that it could impose a higher burden of proof before mitigating unjust and unreasonable prices in the contracts at issue. They state that the Commission can apply the public interest standard to determine whether prices should be mitigated only after it finds that the contract prices at issue here are just and reasonable. NPUC and Complainants state that the contract prices at issue were not just and reasonable at the contract formation because, as determined in the Staff Report, the California PX and ISO spot market dysfunctions adversely affected prices in forward contracts, and the Respondents engaged in fraud, deception and misrepresentation, and market manipulation, resulting in unjust and unreasonable prices. Complainants and NPUC conclude that the forward markets were not competitive during the relevant time and thus could not produce just and reasonable prices. Snohomish adds that pursuant to the Commission precedent, contracts can be modified under the public interest standard where, as here, the contracts were negotiated during a period of market dysfunction and, after the Commission intervention to correct that market dysfunction, the contracts were no longer economical.

14. In addition, Nevada Companies and SCWC argue that the Commission misread the holding in *Sierra* when it found that "[u]nder the 'public

interest' standard, to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary to the public interest." [9] According to the Nevada Companies, under the Commission's interpretation of *Sierra*, as long as two parties reach a voluntary agreement on a contract price, the Commission is powerless to modify that price even if it finds it to be unjust and unreasonable.

15. As discussed below, the Commission has not violated its statutory obligation with respect to modification of contracts, as interpreted by the U.S. Supreme Court. The *Mobile-Sierra* doctrine holds that in cases "where parties have negotiated a ... contract that sets firm prices ... and that denies either party the right to change such prices [] unilaterally, [the Commission] may abrogate or modify the contract only if the public interest so requires."[10] Under the public interest standard, the sole concern of the Commission is whether the challenged rate adversely affects the public interest, [11] and the Commission can exercise its authority to modify contracts only where the public interest demands such action. [12] The burden to

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[9] *See* June 26 Order at 62,397.

[10] Texaco, Inc. v. F.E.R.C., 148 F.3d 1091, 1095 (D.C. Cir. 1998).

[11] FPC v. Sierra Pac. Power Co., 350 U.S. 348, 354-5 (1956).

[12] Union Pac. Fuels, Inc., 129 F.3d 157, 161 (D.C. Cir. 1997) (quoting Metro. Edison Co. v. F.E.R.C., 595 F.2d 851, 856 n.29 (D.C. Cir. 1979).

demonstrate that the contract rates in question in this proceeding are contrary to the public interest is on the Complainants. The Complainants in this proceeding, however, have failed to make such a showing. As established in the June 26 Order and affirmed in this order on rehearing, the contracts at issue are subject to the public interest standard of review. Once a party signs a *Mobile-Sierra* contract, it cannot escape by later claiming that the rates were not just and reasonable when it signed the contract, unless there is evidence such as the seller fraudulently inducing the buyer to execute the contract. However, no such evidence was found in the evidentiary record, including the Staff Report and the 100-Day Discovery Proceeding submittals.

16. In response to the Complainants' arguments that the Commission can apply the public interest standard of review only after it finds that the contract rates were just and reasonable, Complainants fail to acknowledge that the contracts were lawfully entered into pursuant to prior findings and authorization by the Commission under Section 205 of the Federal Power Act (FPA).[13] Upon a showing that the seller lacks or has mitigated market power in the relevant market, the Commission pre-determines under Section 205 of the FPA that sales at market-based rates will be just and reasonable.[14] In effect, the Commission makes a "blanket" just and reasonable determination which applies to subsequent market-based sales made by

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[13] 16 U.S.C. § 824d (2000).

[14] Louisiana Power Auth. v. F.E.R.C., 141 F.3d 364, 365 (D.C. Cir. 1998); Elizabethtown Gas Co. v. F.E.R.C., 10 F.3d 866, 870 (D.C. Cir. 1993).

the seller. As we explained in our June 26 Order, if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of authority a pointless exercise of no value to anyone.

17. The Commission has held that this grant of market-based rate authority constitutes what is known as the "initial review" of rates in the cost-based rate context. Then, if the parties have not agreed to apply the public interest standard to future challenges, a party may come to the Commission pursuant to Section 206 of the FPA[15] and demonstrate that the rate is no longer just and reasonable. Alternatively, a party who does not have such a right may seek changes by demonstrating that the contract rate is contrary to the public interest. In essence, the Complainants attempt to add another layer to this two-step process, claiming that parties to contracts that are subject to the public interest standard of review should have another opportunity to argue that the rate was not just and reasonable at the outset. This argument, however, has no support in either the statute or the relevant Commission or Court precedent. Indeed, the Complainants' suggested approach would create uncertainty in the market, as a party who suddenly finds that its deal has become uneconomical, can undo the terms to which it was contractually bound. This is precisely what the *Mobile-Sierra* doctrine was designed to avoid, and we see no support for an exception to this established doctrine simply because

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[15] 16 U.S.C. § 824e (2000).

a party has contracted in a market-based rate regime.

18. Our decision in *Lockyer*[16] supports this result. The "view that only cost-based or formula rate models satisfy the statutory framework fundamentally misapprehends the Commission's ratemaking authority."[17] *Lockyer* held that market-based rate certificates satisfy the FPA Section 205(c)[18] requirement that rates be on file with the Commission and recognized that the Commission reviews the reasonableness of the use of market-based rates prior to their effectiveness. "Prior review consists, however, not of the particular prices agreed to by willing buyers and sellers. Rather, it consists of analysis to assure that the seller lacks or has mitigated market power so that its prices will fall within a zone of reasonableness."[19]

19. Thus, at the time sellers are granted market-based rate certificates, their rates are subject to the initial review required by the FPA. This review is different than that conducted for cost-based rates because "[t]he availability of genuine alternatives provides a sufficient basis...to conclude that 'market discipline' will be sufficient to keep the prices that sellers charge within the statutorily-prescribed just and reasonable zone."[20] We reject the parties'

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[16] Cal. ex rel Lockyer v. British Columbia Power Exch. Corp., 99 F.E.R.C. ¶ 61,247 (2002) (Lockyer).

[17] *Id.* at 62,062.

[18] 16 U.S.C. § 824d(c) (2000).

[19] *Id.* at 61,247. 62,063.

[20] *Id.*

argument that this approach is insufficient to satisfy the statute. Our decision in *Lockyer* is on all fours with our finding here.

20. Respondents seek clarification that the public interest standard of review does not authorize unjust and unreasonable rates. We clarify as follows. Respondents are correct that rates initially must be just and reasonable. For market-based rates, this determination is made when the authorization for market-based rates is granted. However, if rates subsequently become unjust and unreasonable and the contract at issue is subject to the *Mobile-Sierra* standard of review, the Commission under court precedent may not change the contract simply because it is no longer just and reasonable. If parties' market-based rate contracts provide for the public interest standard of review, the Commission is bound to a higher burden to support modification of such contracts. The public interest standard applies to changes to contract rates and "represents the Supreme Court's attempt to strike a balance between private contractual rights and the regulatory power to modify contracts when necessary to protect the public interest."[21] Our finding that changes to the challenged contracts should be evaluated under the public interest standard does not equate to a finding that the underlying rates are not just and reasonable. To the extent Respondents request for clarification asks the Commission to opine on matters not before us in this case, we decline to do so.

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[21] Northeast Util. Serv. Co., v F.E.R.C., 55 F.3d 686, 689 (1st Cir. 1995).

21. Complainants further argue that the Commission erred in finding that the public interest standard of review is applicable under Section 6.1 of the WSPP Agreement.[22] In particular, they state that the Commission failed to provide explanation for its decision, while disregarding Nevada Companies' and SCWC's witness testimony that they did not intend to bargain away their rights under Section 206 of the FPA.

22. Parties' testimonies and other evidence (such as recordings of trader telephone conversations) provided no indication that the issue of the applicable standard of review was ever mentioned by either Complainants or their counterparties at the time the contracts at issue were negotiated and executed. The burden was on the Complainants to prove that the intent of the parties was to allow for Complainants to make unilateral changes to the terms of the contracts in question. Complainants failed to present any evidence on this issue. For this reason, in our decision, we affirmed the Presiding Judge's finding that:

> ...the reference to a "joint" Section 205 filing evidences an intent that neither seller nor buyer be able to seek changes under Section 205 or 206 of the FPA other than under the "public

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[22] Section 6.1 of the WSPP Agreement states in part as follows: "Nothing contained herein shall be construed as affecting in any way the rights of the Parties to jointly make application to F.E.R.C. for a change in the rates and charges, classification, service, terms, or conditions affecting WSPP transactions under Section 205 of the Federal Power Act and pursuant to F.E.R.C. rules and regulations promulgated thereunder..."

interest" standard of review. Although the parties could have used specific language disallowing a unilateral filing by the seller under Section 205, or the filing of a complaint by the buyer under Section 206 of the FPA, the most reasonable reading of Section 6.1 is that they intended to exclude any unilateral filings at the Commission.[23]

23. SCWC and Snohomish argue that Section 6.1 does not apply to individual transactions under the WSPP Agreement. In their opinion, it only applies to adding or removing Service Schedules under the WSPP Agreement.

24. We disagree. The relevant language in Section 6.1 of the WSPP Agreement explicitly refers to possible changes in the rates, charges, classification, service, terms, or conditions for transactions entered into pursuant to the WSPP Agreement, and not just Service Schedules appearing in the last part of the WSPP Agreement. In particular, Section 6.1 of the WSPP Agreement states in pertinent part as follows:

...Nothing contained herein shall be construed as affecting in any way the rights of the Parties to jointly make application to FERC for a change in the rates and charges, classification, service, terms, or conditions affecting WSPP transactions under Section 205 of the Federal Power Act and pursuant to FERC rules and regulations promulgated thereunder... (Emphasis added).

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[23] *See* June 26 Order at 62,388.

25. In addition, Respondents ask the Commission to clarify that in the absence of explicit contractual language allowing unilateral contract modifications under Section 206 of the FPA, the party seeking change must meet the public interest standard. As we explained in the Rehearing Order, [24] "the evidentiary hearing was established to interpret Section 6.1 of the WSPP Agreement and to ascertain the intent of the parties at the time the contracts in question were signed."[25] In the June 26 Order, based on the evidence developed at the hearing and the Presiding Judge's conclusions, we determined that "the parties to the challenged contracts did not intend to retain for Complainants the right to unilaterally seek changes to their contracts."[26] Thus, we concluded that the Complainants must meet the burden of proof under the public interest standard of review to justify modification of the contracts.

26. Nevada Companies, however, argue that pursuant to *Union Pacific*,[27] the parties' failure to explicitly address the issue of the applicable standard of review signifies the parties' intent to apply the just and reasonable standard of review. *Union Pacific* is inapposite in the instant circumstances. First, the contracts at issue in *Union*

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[24] Nev. Power Co. & Sierra Pac. Power Co. v. Enron Power Mktg., Inc., *et al.*, *et al.*, 100 F.E.R.C. ¶ 61,273 (2002) (Rehearing Order).

[25] *Id.* at 62,047.

[26] *See* June 26 Order at 62,388.

[27] Union Pacific Fuels, Inc. v. F.E.R.C., 129 F.3d 157 (D.C. Cir. 1997).

Pacific contained a so-called Memphis [28] clause allowing unilateral contract changes. Second, the issue in *Union Pacific* was whether or not the Commission acting *sua sponte* is bound by the public interest standard. The Court in *Union Pacific* distinguished between restrictions on the contracting parties' rights to unilaterally change rates and the Commission's right to modify contractual rates. The Court thus concluded that absent explicit language limiting the Commission's authority to modify the contract, the *Mobile-Sierra* doctrine is inapplicable to rate changes initiated by the Commission.

27. NPUC also argues that the appropriate standard of review for the contracts at issue is the just and reasonable standard and that the Commission set the public interest standard as the default standard for contract modification when parties are silent on the standard of review in their agreements, which contradicts court and Commission precedent. NPUC's contention is incorrect. We set the issue of the applicable standard of review for hearing to determine the intent of the parties. Consequently, our decision in the June 26 Order rests on the testimony and the Presiding Judge's conclusions interpreting the intent of the parties, as reflected in Section 6.1 of the WSPP Agreement.

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[28] *See* United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div., 358 U.S. 103 (1958).

28. SCWC further argues that *Texaco*[29] cited in the June 26 Order is also inapposite in the instant case because the WSPP Agreement is not a fixed-rate contract addressed in *Texaco*. SCWC(s contention is without merit. Confirmation Agreements at issue here have a fixed price. Section 38 of the WSPP Agreement cited by SCWC in support of its position requires the parties to the WSPP Agreement to specify a floating price when they intend that the price for a transaction be based on an index. Moreover, the Court in *Texaco* held that the *Mobile-Sierra* doctrine applies regardless of whether parties to a contract agreed to a specific rate or whether they agreed to a rate changeable in a specific manner.[30]

29. Snohomish and NBCP also contend that the application of the *Mobile-Sierra* public interest standard of review to market-based rate contracts is inappropriate and contrary to law. We addressed this issue in the June 26 Order on pages 62,388-89, paragraph 37. In response to the contention that the public interest standard does not apply to the market-based rate contracts at issue here because these contracts have not been previously reviewed and accepted for filing by the Commission, we stated that:

> The need for prior Commission review in these circumstances was met when, after determining that the Respondents lacked market power or

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[29] *See* Texaco Inc. v. F.E.R.C., 148 F. 3d 1091 (D.C. Cir. 1998).

[30] *See Id.* at 1096.

had taken steps to mitigate it, the Commission authorized all of the Respondents in this proceeding to make sales of power at market-based rates. A seller that has been granted market-based rate authority may enter into power sales contracts without first seeking Commission authorization of the provisions of an individual contract (except for certain affiliate contracts). The Commission is not required specifically to review each agreement since the Commission, when it grants umbrella market-based rate authorization, pre-determines that rates under future contracts entered into pursuant to the market-based rate authorization will be just and reasonable. The "just and reasonable" standard of Section 205(e) of the FPA is satisfied by the Commission's determination that the utility (and its affiliates) lacks market power or has taken sufficient steps to mitigate market power. As noted in *GWF Energy, LLC*,[31] if we were required to examine every long-term service agreement as if the seller was seeking new market-based rate authority, it would make the original grant of market-based rate authority (*i.e.*, the original acceptance of the market-based rate tariff) a pointless exercise of no value to anyone. (*Footnotes omitted*).

30. In addition, Snohomish argues that the *Mobile-Sierra* doctrine applies only in situations where a regulated utility is challenging a contract with a rate it argues is too low. As we stated in the June 26 Order on page 62,384, paragraph 7, "[i]n

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[31] *See* GWF Energy, LLC, 98 F.E.R.C. ¶ 61,330, at 62,390 (2002).

later cases, the *Mobile-Sierra* doctrine was applied to contracts containing rates that allegedly were too high." Snohomish, however, believes that the *PSC of New York* [32] case the Commission relied on is inapposite. We disagree. The Court in *PSC of New York* held that the *Mobile-Sierra* doctrine protects contracts, not rates; it obligates both buyers and sellers, and the Commission is no more at liberty to alter a contract "to the prejudice of the producers than to do so in their favor." [33] In addition, the *Mobile-Sierra* doctrine has been applied in other cases where a complainant sought to reduce the existing rate.[34]

31. Snohomish further argues that the Commission should have reviewed the contracts at issue under the just and reasonable standard to protect the rights of third parties, specifically, Snohomish's ratepayers who intervened in this case. In addition, Snohomish, NBCP, and NPUC contend that the Commission at the very least should have applied the flexible public interest standard.[35]

32. As we stated in the June 26 Order on page 62,389, paragraph 41, "[t]here is no Commission or court precedent that supports a finding that a non-signatory party may challenge a *Mobile-Sierra*

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[32] *See, e.g.*, Pub. Serv. Comm'n of N.Y. v. FPC, 543 F.2d 757 (D.C. Cir. 1974) (PSC of New York).

[33] *Id.* at 798.

[34] *See, e.g.*, Potomac Elec. Power Co. v. F.E.R.C., 210 F.3d 403 (D.C. Cir. 2000).

[35] They cite to Northeast Utils. Serv. Co., 66 F.E.R.C. ¶ 61,332 (1994).

contract under the 'just and reasonable' standard of review, as opposed to the 'public interest' standard of review." The cases cited by Snohomish as dictating application of the just and reasonable standard of review are inapposite. In *PJM Interconnection, LLC*, [36] the Reliability Assurance Agreement explicitly permitted PJM to submit filings under Section 206 of the FPA.[37] In the instant proceeding, the contract in question does not contain such a provision. Snohomish also cites to *Carolina Power and Light Co.*, [38] which involved a Commission directive to revise a settlement agreement that had been submitted for Commission acceptance, and not, as in this case, a complaint challenging an existing market-based rate contract for the sale of power. Finally, Snohomish refers to *Pennsylvania Electric Co.*, [39] which speaks in general terms about the Commission's statutory duty to ensure just and reasonable rates. However, the Commission has applied the public interest standard to challenges brought by non-contractual parties.[40] In addition, we found no basis for applying a more flexible public interest standard to the contracts at issue. The record shows that the third-party intervenors, i.e., Snohomish's retail ratepayers, were not adversely

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[36] PJM Interconnection, LLC, 96 F.E.R.C. ¶ 61,206 (2001).

[37] *See Id.* at 61,878 n.12.

[38] Carolina Power & Light Co., 69 F.E.R.C. ¶ 61,078 (1994).

[39] Pa. Elec. Co. v. F.E.R.C., 11 F3d 207 (D.C. Cir. 1993).

[40] *See, e.g.*, Public Util. Comm'n Cal. v. Sellers of Long Term Contracts, 100 F.E.R.C. ¶ 61,098, at 61,396 (2002).

affected by the contract at issue. As we found in the June 26 Order:

> The Snohomish-Morgan Stanley contract is no more than five percent of Snohomish's portfolio costs and constitutes only three percent of Snohomish's load, resulting in an eight percent increase over 2001 rates, while other contracts account for rate increase of fifty-one percent. Moreover, Snohomish's rate increase occurred prior to Snohomish's negotiating its contract with Morgan Stanley, and prior to issuing the RFP for the power purchase in question. (*Footnotes omitted*).[41]

33. Similarly, the Nevada Companies failed to show that the contracts at issue imposed an excessive burden on their ratepayers.

34. Nevada Companies further argue that the holding in the June 26 Order contradicts the approach taken by the Commission in its Proposed Policy Statement. [42] Under the Proposed Policy Statement, unless a contract contains the proposed language, the just and reasonable standard of review would apply to the contract. If adopted, the Policy Statement will apply on the prospective basis only, specifically, to contracts entered into 30 days after the date of issuance of the Final Policy Statement. Numerous parties filed comments to the Proposed Policy Statement raising various issues. The

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[41] *See* June 26 Order 62,398.

[42] Standard of Review for Proposed Changes of Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 100 F.E.R.C. ¶ 61,145 (2002).

Commission is currently reviewing all of the comments.

35. Snohomish argues that Section 39B in its contract with Morgan Stanley [43] bars unilateral changes affecting only rates for service, while Snohomish challenges the term of the contract in this proceeding. We addressed this issue in the June 26 Order on page 62,389, paragraph 39. Specifically, we stated that:

> In a contract entered into pursuant to market-based rate authority, the negotiated term is intricately linked to the contract rate. The primary basis for Snohomish's complaint is the allegation that the rate in its contract with Morgan Stanley is unjust and unreasonable, not that the term of the contract is unjustifiably long.

Challenges to the Findings Involving the *Sierra* Three-Prong Test

36. On the question of whether the Nevada Companies' contracts imposed an excessive burden on their customers, NBPC acknowledges that the retail rates decreased, but argues that the Nevada Companies' customers paid significantly more than they would have if the prices had been reasonable.

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[43] Section 39B of the Confirmation Agreement between Snohomish and Morgan Stanley states: "The rates for service specified in this Agreement shall remain in effect for the term of this Agreement and shall not be subject to change through application to F.E.R.C. pursuant to the provisions of Section 205 or 206 of the Federal Power Act."

However, Complainants failed to produce record evidence on the effect of the contracts at issue on Nevada Companies' customers.

37. SCWC argues that the Commission erred in finding that the SCWC-Mirant contract's effect on SCWC retail customers was minimal. According to SCWC, its ratepayers have seen an overall 38 percent increase in their electric bills. As a result of this rate increase, as approved by the California Public Utilities Commission (CPUC), SCWC was allowed to recover a portion of the costs of the Mirant contract up to a weighted average cost of energy of $77/MWh.

38. In the June 26 Order, we stated:

> SCWC offered no evidence showing that the challenged contracts impose an excessive burden on its customers. The record evidence establishes that there was no rate increase for SCWC's ratepayers who are permanent residents of SCWC's service territory pursuant to the terms of the settlement between SCWC and CPUC. Under the terms of the settlement, the other group of SCWC's ratepayers, owners of second homes in SCWC's service area, were to face an average monthly electric bill of $35.13. (*Footnotes omitted*).[44]

The bottom line for the public interest test is not the percentage increase as compared to prior rates. The public interest test requires a showing

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[44] *See* June 26 Order at 62,398.

that the contract places an excessive burden on ratepayers sufficient to modify the contract. SCWC has not shown how a $35.13 monthly electric bill amounts to an excessive burden on the ratepayers. Moreover, the weighted average cost of energy of $77/MWh, which SCWC cites as a compelling piece of evidence, is only $3 more than the $74 advisory benchmark that SCWC believes would be a just and reasonable price for its contract with Mirant.

39. Snohomish also disagrees with the Commission's conclusion that its contract with Morgan Stanley did not impose an excessive burden on its ratepayers. Snohomish does not challenge the Commission's finding that "[t]he Snohomish-Morgan Stanley contract is no more than five percent of Snohomish's portfolio costs [] and constitutes only three percent of Snohomish's load, resulting in an eight percent increase over 2001 rates, while other contracts account for rate increase of fifty-one percent []."[45] However, Snohomish argues that the five percent threshold is arbitrary. Snohomish also provides the amounts representing the burden imposed on Snohomish's ratepayers by the contract in question.

40. In our decision on this issue, we relied on the following record evidence. The Morgan Stanley contract resulted in an eight percent increase over 2001 rates, while other Snohomish contracts account for a rate increase of fifty-one percent. Moreover, Snohomish's rate increase occurred prior to Snohomish's negotiating its contract with Morgan

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[45] *See Id.*

Stanley, and prior to issuing a Request for Proposals (RFP) for the power purchase in question.[46]

41. Snohomish further argues that the Commission's finding that Snohomish started the RFP process after the Snohomish Board authorized the retail rate increase is a *non sequitur*. According to Snohomish, the rate increase approval was directly related to the Snohomish-Morgan Stanley contract because the rate increase allowed Snohomish to pay the exorbitant cost of the contract in question.

42. Snohomish's Board approved the rate increase on December 13, 2000,[47] while Snohomish issued the RFP on December 22, 2000.[48] In other words, the rate increase took place prior to the initiation of the RFP process. We do not see the causal link between the contract in question and the rate increase, since the latter preceded even the solicitation of power.

43. Similarly, Snohomish challenges the Commission's determination that Snohomish failed to present evidence that its contract with Morgan Stanley was unduly discriminatory to the detriment of other purchasers who are not parties to the contract at issue. Snohomish contends that the Commission ignored evidence demonstrating that the contract has produced devastating consequences for electric customers in Snohomish County.

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[46] *Id.*

[47] Ex. SNO-1 at 4:19-5:2; Tr. at 1720-23; 1724.

[48] Ex. MSC-8 at 3-4; Tr. 1735, 1737.

44. We are aware that Snohomish's retail rates are higher than the historical average; however, as we stated above, there is no evidence in the record that the rate hike was caused by the contract at issue.

The Commission's $74/MWh Advisory Benchmark

45. Complainants also argue that the Commission failed to offer any justification for upholding the contract prices in excess of its $74/MWh benchmark price.

46. Complainants refer to our December 15, 2000 Order [49] in which we declined to extend the California spot market mitigation measures to forward markets.[50] In that order, we also adopted an advisory benchmark of $74/MWh for five-year contracts for supply around-the-clock to be used as a reference point in addressing any complaints regarding the pricing of contracts negotiated in forward markets. While we expected that the benchmark would be helpful in assessing possible complaints challenging forward prices, we never suggested that a contractual price exceeding the benchmark would be all by itself a sufficient ground for abrogating a contract. Quite to the contrary, we expected that "buyers may elect to negotiate above [the benchmark] to the extent they believe the particular contract or supplier brings value which

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[49] San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs., 93 F.E.R.C. ¶ 61,294 (2000).

[50] *Id.* at 61,994.

suits their needs (e.g. shorter-term contracts, favorable terms and conditions, assignment of the risk of variable cost exposure, the particular characteristics of the supplier or its resource portfolio, etc.)."[51]

47. The record in this case shows that the SCWC contract provides a significant benefit, which SCWC emphasized when testifying before the CPUC. Energy is typically traded in 25-MW blocks, and Mirant took on the risk of supplying SCWC with a 15-MW "odd lot" sale. SCWC recognized in its CPUC testimony that a 15 MW block of energy should carry (a slight pricing premium.)[sic][52] A reliable supply of firm energy was particularly important to SCWC, since it had no resources of its own. Mirant's contract offered greater capacity-like reliability benefits than a unit-specific contract. A unit-specific contract would have resulted in too much system unreliability for such a small system.[53] Moreover, SCWC's RFP never specified a target price of $74/MWh and there is no record evidence that any representative from SCWC told Mirant that it sought a price of $74/MWh.[54]

48. Similarly, the record shows that Snohomish did not specify in its RFP the target price of $74/MWh. Quite to the contrary, Snohomish was specifically authorized by its Board to enter into a contract with a price as high as $125/MWh.

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[51] *Id.* at 61,995.

[52] Ex. MAEM-30 at JAD-10-11.

[53] *Id.*

[54] *See* Initial Decision at 65,307 n.444.

49. Moreover, for comparison purposes, the advisory benchmark cannot be taken at face value. The $74/MWh advisory benchmark represents a suggested price for five-year contracts for supply around-the-clock, whereas all Nevada Companies' contracts are for 12 months or shorter for standard on-peak 6x16 blocks of power. Nevada Companies failed to provide any calculations adjusting the $74/MWh benchmark to reflect the terms of their specific contracts. As a result, neither the Presiding Judge nor the Commission had any evidence on which to assess the Complainants' arguments regarding the relationship of the challenged contract prices to the advisory benchmark.

50. Furthermore, Complainants argue that the Commission, while providing relief to purchasers in the California spot market, reneged its promise to assess complaints regarding the justness and reasonableness of prices in forward bilateral contracts executed during the time the spot market was dysfunctional. SCWC adds that, in accordance with the December 15 Order, it believed that the price in its contract with Mirant would be modified if proved to be unjust and unreasonable.

51. These contentions are without merit. The December 15 Order never mandated the application of the ["just and reasonable"] standard of review to forward contracts. Under the ["public interest"] standard applicable to the SCWC-Mirant contract, SCWC was required to show that the contract price at issue is contrary to the public interest, which it failed to do.

Totality of Circumstances

52. Nevada Companies and NBCP state that in its analysis of the "totality of circumstances," the Commission inappropriately focused on the Complainants' buying practices and ignored many other factors. Nevada Companies argue that whether they had other alternatives is irrelevant to the issues in this case. Furthermore, they contend that the alternatives available at the time of formation of the contracts were not true alternatives because Nevada Companies were prohibited by the state law from entering into any contracts with a term longer than three years.

53. The availability of other alternatives and the Complainants' buying practices are indicative of circumstances under which the transactions in question were executed. The availability of more competitively priced products demonstrates that the Complainants were not induced to enter into the transactions at issue. They were free to reject offers that led to execution of the contracts in question, and turn to other suppliers. In response to Nevada Companies' contention that it was prohibited to enter into contracts with a term longer than three years, we note that all of the contracts at issue here are 12 months or shorter, even though (according to the Nevada Companies) the state law allowed contracts up to three years long.

54. Snohomish also argues that it did not have any meaningful alternatives at the time the contract was executed. According to Snohomish, the Western forward market was illiquid; the response rate to its RFP was very low; and two of the five bidders that

responded refused to offer the firm, around-the-clock, quality of power service needed to serve Snohomish's customers reliably. The three remaining bids, Snohomish continues, were not meaningful alternatives either because they did not offer supply of sufficient quantity. Furthermore, Snohomish argues that contrary to the Commission's finding in the June 26 Order, it was never offered shorter-term contracts.

55. The record shows that Snohomish had an option of executing a contract for a shorter term than its contract with Morgan Stanley or entering into two separate agreements with a total term of the challenged contract. Specifically, one of the alternative bids from Morgan Stanley provided for power for periods of one, two or three years with gradually decreasing prices, respectively.[55] Morgan Stanley also offered Snohomish to enter into an alternative arrangement of two separate deals, one for five years (at above market prices) and another for five-seven years (at below market prices).[56] Snohomish rejected either of these alternatives. Instead, Snohomish chose to pass the risk of price volatility to Morgan Stanley and pay a below market rate of $105 for the first several years, even if the contract had to be for a longer term. Snohomish expected, based on its forward curve dated April 2001, that its contract with Morgan Stanley would provide Snohomish with power at a price far below market for at least two years.[57]

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[55] Tr. 1735, MSC-10.

[56] Tr. 3992-93.

[57] Ex. MSC-37 at 22:22-23:3, Ex. MSC-50.

56. SCWC also takes issue with the Commission's determination that it had alternatives to the Mirant contract. It agrees with the Commission's finding that, in response to its RFP, it received three different proposals with varying options. However, according to SCWC, none of these responses were acceptable because they were tainted by the dysfunctions in the spot market.

57. The record shows that the price and the term of the contract SCWC is now challenging were consistent with SCWC's RFP, which contained a target price of $90/MWh and requested bids for one-to-seven year contracts.[58] SCWC issued the RFP to only six suppliers,[59] and as a result, received three responses containing varying options.[60] SCWC chose the contract terms suggested by Mirant. Even though the contract price offered by Mirant was slightly higher that the RFP target price, it was accepted by SCWC because, as recognized by SCWC in its testimony to CPUC, a 15 MW block of energy should carry a slight pricing premium.[61]

58. SCWC further challenges the Commission's finding that "it was SCWC's choice to wait until March 2001 when the energy prices were at their peak to start a bid solicitation process to replace its

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[58] Tr. 2900-02 and Ex. MAEM-2 at 13; MAEM-9; Tr. 2901:1-4, 2903:3-7; and 2904-5; Ex. SCW-4 at 12; SCW-1 at 12:5-10:24:10-12.

[59] Tr. 2893:19-2894:20; Ex. SCW-1 at 17:1-8.

[60] Tr. 2894:21-24; 2944:10-17.

[61] Ex. MAEM-30.

contract with Dynegy Inc. that was to expire in May 2001." [62] SCWC states that it could not have forecasted that in March 2001 prices would be at their peak because there was no information at the time to support such forecast. SCWC adds that it started the RFP process seven weeks prior to expiration of its previous contract with Dynegy Inc., which is, in SCWC's opinion, a reasonable time beforehand.

59. We made the challenged finding based on the record, which shows that in October 2000, after a summer of high prices, SCWC rejected an offer by Dynegy Inc. to extend its contract with SCWC on a "blend and extend" rate of between $46.50/MWh to $54.50/MWh, depending on the length of the proposed contract.[63] At that time, SCWC knew that the prices had risen substantially above the historical levels, and were well above the $35.50/MWh price in its one-year contract with Dynegy Inc. However, SCWC failed to act to secure supply until March 2001 when the prices were at their peak.

60. SCWC further argues that while it is true that the SCWC-Mirant contract did not impose a financial burden on SCWC, the Commission was wrong to determine that SCWC derived profit from its sale of energy back to Mirant. SCWC contends that the money received from Mirant was credited to SCWC's retail customers.

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[62] *See* June 26 Order at 62,399.

[63] *See* Ex. MAEM-16 at 21:6-22:2, MAEM-24, and MAEM-25.

61. We do not see how this fact should change the outcome of our analysis in the June 26 Order. The burden was on SCWC to show that SCWC and its retail customers suffered financial hardship as a result of its contract with Mirant. SCWC also agrees on rehearing that the SCWC-Mirant contract did not impose a financial burden on SCWC.[64]

62. SCWC further contends that the Commission's finding that by entering into the contract with Mirant, SCWC avoided the risk of price volatility and achieved rate certainty is irrelevant because that is the effect of any fixed-rate forward contract, by definition.

63. The record shows that SCWC was willing to enter into a contract of a considerable length in order to secure the price it wanted.[65] The record evidence also establishes that SCWC agreed to the contract in spite of the fact that it did not expect high prices to persist for long due to a number of things, such as California streamlining authorizations for new generation; demand shifts from spot to forward markets; etc.[66] Thus, SCWC chose to avoid price volatility by shifting the risks on to Mirant. However, after the spot market prices fell below the level SCWC expected, SCWC became dissatisfied with the bargain.

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[64] *See* SCWC's Rehearing Request at 74.

[65] *See* Initial Decision at 65,307.

[66] *Id.*

64. Furthermore, Snohomish argues that the June 26 Order suggests two contradictory tests for meeting the burden of proof under the public interest standard of review. According to Snohomish, these tests are the *Sierra* three-prong test and the requirement to show market manipulation specific to the contracts at issue, as well as "unfairness, bad faith, or duress during the original negotiations." In the alternative, Snohomish and Nevada Companies argue that their contracts were the product of market manipulation by Enron, Morgan Stanley and other Respondents, which, as established by the Commission Staff, engaged in market manipulation. NPUC and NBCP add that the June 26 Order contradicts the Commission's findings regarding two Enron power marketers, which were found by the Commission to have manipulated spot markets.

65. We disagree. In the June 26 Order, we did not create two different public interest tests. Our statement that "there [was] nothing in the record before the ALJ, in the Staff Final Report, or in the 100-Day Discovery Proceeding evidence to support a finding that there was market manipulation *specific to* the long-term contracts at issue here" was in response to the Complainants contention that contract modification is warranted based on the Staff Report findings and the 100-Day Discovery Proceeding allegations of manipulation in the spot market. We reviewed the Staff Report findings and evidence submitted in the 100-Day Discovery Proceeding and found no evidence to support a finding of market manipulation that specifically affected the contracts at issue.

66. SCWC and Snohomish also challenge the Commission's finding that "because there is no evidence of unfairness, bad faith, or duress in the original negotiations, the Complainants are not entitled to change their bargains." In SCWC's opinion, this finding is outside the scope of the hearing. Snohomish contends that the showing of unfairness, bad faith, or duress is not required to meet the public interest standard.

67. We disagree. In the April 11 Order, we instructed the Presiding Judge to consider and the parties to submit evidence on the totality of purchases and sales and the conditions present at the time the contracts were entered into. As we stated in the Rehearing Order, the instructions were tailored to "assist the judge in focusing on the main issue that the hearing is intended to resolve."[67] Whereas "unfairness, bad faith, or duress in the original negotiations" were not explicitly mentioned, such evidence could be relevant to the conditions present at the time of contract formation and whether the Commission should uphold or modify the challenged contracts. Moreover, as we stated in the Rehearing Order, the list of evidentiary requirements was not exclusive; the parties were free to offer other evidence deemed by the Presiding Judge to be relevant to the Commission-prescribed scope of the hearing.[68]

68. In response to Snohomish's contention, we believe that a showing of fraud, duress, or bad faith

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[67] *See* Rehearing Order at 62,048.

[68] *Id.*

between the parties at the contract formation stage could be an alternative ground for modifying the challenged contracts. Our review of a broader range of evidence concerning the circumstances surrounding formation of the contracts at issue imposed no harm on the Complainants. However, the Complainants failed to make this showing; they also failed to meet the *Sierra* three-prong test or demonstrate the contract abrogation is justified based on the totality of circumstances.

69. Snohomish further argues that the evidentiary record contains evidence of duress and exercise of market power by Morgan Stanley. According to Snohomish, Morgan Stanley was aware of Snohomish's need to conclude the transactions as soon as possible and that Snohomish had no other suppliers to turn to. In Snohomish's opinion, the fact that Morgan Stanley refreshed offer prices constitutes a compelling evidence of an exercise of market power. Snohomish adds that Snohomish was afforded by Morgan Stanley very little time to review the proposed contract.

70. The evidentiary record does not support Snohomish's allegations. The record demonstrates that Snohomish required Morgan Stanley to submit its bid twice with modified terms suggested by Snohomish.[69] Snohomish was represented by counsel during the negotiations of the contract.[70] Snohomish dictated the deadlines to complete negotiations and

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[69] Tr. at 1743:20-1744:5; 1752-53; 3984-85; Ex. MSC-8 at 10.

[70] Ex. MSC-55 at 7:21-23.

several of the contract terms.[71] The evidence also demonstrates that, shortly after Snohomish entered into the contract, it stated to its customers that the Morgan Stanley and other forward contracts "give [it] a lot of security against the uncertainty of market fluctuations," and that the contracts insulate the ratepayers from market volatility.[72]

71. In addition, Nevada Companies and Snohomish further contend that the Commission erred in relying in its decision on *PEPCO* in which the court held that a showing of "a mere rate disparity or a benefit to the purchasing utility or its customers for a rate modification does not suffice, without more, to satisfy [the 'public interest'] standard."[73] In Nevada Companies' and Snohomish's opinion, *PEPCO* and the instant case are factually different and thus *PEPCO* is inapplicable.

72. In deciding whether the Complainants met their burden of proof under the public interest standard of review, we were guided by the court case law developed over several decades. Upon the review of the evidentiary record developed in this proceeding, the findings of the Staff Report, and evidence submitted in the 100-Day Discovery Proceeding, we concluded that the challenged contracts were not contrary to the public interest because the Complainants failed to demonstrate that the contracts in question caused financial distress

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[71] Tr. at 1762:15-17; 1762:18-22.

[72] Ex. MSC-83 at 6; Ex. MSC-78 at 7:10-12.

[73] *See* Potomac Elec. Power Co. v. F.E.R.C., 210 F.3d 403, 404 (D.C. Cir. 2000).

for the Complainants so as to threaten their ability to continue service, that the contracts cast an excessive burden on their customers, that the contracts were unduly discriminatory to the detriment of other customers that were not parties to this proceeding, or that any other factors in the record of this proceeding demonstrated that the contracts were contrary to the public interest.[74]

Snohomish's Motion to Reopen the Record

73. Further Snohomish argues that it was denied an opportunity to address and/or rebut conclusions set forth in the Staff Report and the 100-Day Discovery Proceeding. In deciding this case, the Commission considered the Staff Report findings and the evidence submitted in the 100-Day Discovery Proceeding upon the Complainants' request. When Snohomish requested the Commission to take official notice of these two proceedings, it was well aware that findings and allegations in these proceedings were contested. We, however, agreed to consider evidence contained in these two proceedings as part of the evidentiary record developed in the instant case.

74. Snohomish further challenges the Commission's decision not to consider evidence submitted in other California-related proceedings. As we explained in the June 26 Order on page 62,402, paragraphs 131-32:

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[74] *See* June 26 Order at 62,382 & 62,384.

> The Commission may reopen the record in its discretion where there is good cause. The Commission views good cause as consisting of extraordinary circumstances, that is, a change in circumstances that is more than just material, but goes to the very heart of the case. In deciding whether to exercise its discretion, 'the Commission looks to whether or not the movant has demonstrated the existence of extraordinary circumstances that outweigh the need for finality in the administrative process.' As the Commission explained in Opinion No. 238, 'we recognize of course that changes have occurred since the close of the record. But such changes always occur. Yet litigation must come to an end at some point. Hence the general rule is that the record once closed will not be reopened.'
>
> The information now in the record provides a sufficient basis for our conclusions here. The evidence that Complainants seek to introduce into the record will not change the outcome of this proceeding... (*Footnotes omitted*).

Collateral Annex

75. Snohomish argues that the Commission should reconsider its decision upholding the Collateral Annex.

76. In the June 26 Order, we found that:

> the WSPP Agreement, Collateral Annex, Confirmation Agreement and Attachment A form a single, integrated agreement, which, as we held above, is to be reviewed under the "public

interest" standard. Consistent with our conclusions above, Snohomish has failed to justify modification of the Collateral Annex.[75]

77. On rehearing, we reiterate that the WSPP Agreement, Collateral Annex, Confirmation Agreement and Attachment A form a single, integrated agreement, and that the Collateral Annex should be reviewed under the public interest standard. Even if Snohomish's contention that Section 39B does not apply to the Collateral Annex were correct, the Collateral Annex would still be subject to the public interest standard of review in light of our finding that, in accordance with Section 6.1 of the WSPP Agreement, the parties intended the application of the public interest standard of review. If Section 39B were not dispositive in regard to the Collateral Annex, then Section 6.1 of the WSPP Agreement would apply. Thus, any challenges to the Collateral Annex should be evaluated under the public interest standard of review. Furthermore, because the Collateral Annex is an integral part of the Snohomish-Morgan Stanley contract, the Collateral Annex cannot be examined separately from the rest of the contract. In the June 26 Order, we extensively analyzed all the evidence pertaining to the Snohomish-Morgan Stanley contract and concluded that Snohomish failed to present sufficient evidence showing that its contract with Morgan Stanley is contrary to the public interest.

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[75] *See* June 26 Order at 62,400.

Mirant Bankruptcy

78. On September 12, 2003, the Bankruptcy Court for the Northern District of Texas issued a "Temporary Restraining Order Against the Federal Energy Regulatory Commission" ("TRO") in *In re Mirant Corp.* (*Mirant Corp. v. FERC*), Adversary Proceeding No. 03-4355, which enjoins the Commission "from taking any action, directly or indirectly, to require or coerce the [Mirant] Debtors to abide by the terms of any Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the Court unless FERC shall have provided the Debtors with ten (10) days' written notice setting forth in detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this paragraph."

79. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Commission will appeal that order. Despite the Commission's disagreement with the validity of the TRO and its expectation that the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days' written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this Order requires Mirant to act in a manner proscribed by the TRO, the Order will provide written notice to Mirant of the action that FERC will take with respect to a covered Mirant Wholesale Contract, which action

will not become effective until ten (10) days after issuance of this Order. In all other respects, this Order is effective immediately.

Requests for Rehearing of the April 23 Order

80. The April 23, 2003 was issued in response to a motion filed by SCWC and Snohomish in which they requested that the Commission disclose alleged prohibited off-the-record communications during a March 26, 2003 press conference attended by three commissioners and a conference call the same day between two commissioners and a group of Wall Street analysts. The Commission disagreed with movants' characterization of the briefings as prohibited off-the-record communications; nevertheless, to allay any concerns, the Commission granted movants' request for disclosure and directed its staff to place a transcript of the press conference and a summary of the telephone conference in the decisional record in this proceeding. The Commission stated that the transcript and summary would apprise the parties of any non-public communication, thereby maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused in this proceeding. Accordingly, the Commission also denied Snohomish's additional request that Chairman Wood and Commissioner Brownell recuse themselves from the oral argument scheduled for that day and from any further decision making in this proceeding.

81. On May 23, 2003, SCWC and Snohomish filed a timely request for rehearing of the April 23 Order.

Ex Parte Allegations

82. SCWC and Snohomish first contend that the Commission erred in finding that the conference call did not violate Rule 2201 of the Commission's regulations, 18 C.F.R. § 385.2201, and that Chairman Wood and Commissioner Brownell were not required to recuse themselves from further participation in this proceeding. They claim specifically that the Commission's Revised Summary of Events and Invitation List show that Chairman Wood and Commissioner Brownell violated Rule 2201 in the conference call by offering opinions about the merits and their likely votes in this and other contract proceedings. They also point to portions of an April 8, 2003 news article by Jason Leopold, which claimed that analysts from Schwab Capital Markets, Lehman Bros., Prudential, and Morgan Stanley stated that Commissioner Brownell said she and Chairman Wood would vote to uphold the contracts. They argue that even if the Commissioners only repeated what they said at the open meeting, the conversation still violated Rule 2201.

83. SCWC and Snohomish's arguments are without merit. The summary of the call demonstrates what it was -- an effort to brief the financial community on action taken by the Commission that same day at its public meeting with respect to important and controversial cases involving the California and Western energy markets. Understandably, the major impact those actions could have on the market would interest the financial community. Likewise of interest were the

actions scheduled to be taken and postponed, but nevertheless discussed at the public meeting, in particular as relevant here Nevada Power's long-term contracts. Naturally, the analysts also inquired about these cases. Such inquiries in the context of a briefing, however, do not constitute a communication on the merits capable of influencing a decision, the prerequisite for an *ex parte* violation.[76] If that were the case, the Commission's *ex parte* rule could impede the Commissioners from expressing themselves or offering their opinions to the public, a common and necessary part of their jobs as public servants.

84. To be sure, there is a fine line between a briefing or a speech and a discussion on the merits capable of influencing a decision. But clearly that line was not crossed here. First, contrary to what SCWC and Snohomish gleaned from Mr. Leopold's news article, nothing particularly new was discussed in the relatively brief (approximately 45 minutes) conference call. Also, there is no indication even from that article or from the Summary that anyone tried to influence the decision in this proceeding. In fact, the Inspector General of the Department of Energy, who was asked by two U.S. Senators to investigate the matter, "did not identify evidence, based on that available record, substantiating the allegation that the conduct of the call violated any Commission procedural rule."[77] For this purpose, the Inspector General interviewed 17 Wall Street representatives

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[76] *See* 18 C.F.R. § 2201(c)(5) (2003).

[77] U.S. Department of Energy Office of Inspector General Special Inquiry, DOE/IG - 0610 June 2003.

from 12 companies, nine of whom acknowledged participating in some or all of the conference call.[78] As the Inspector General found, "[n]one of [them] stated that Chairman Wood or Commissioner Brownell explicitly indicated, during the conference call, how they would vote on the contract cases."[79]

85. SCWC and Snohomish's concern that the Commissioners' statements might bind them to a particular vote is likewise unfounded. The cases they cite are inapposite, because those cases involved public statements made by decision makers that they would vote a certain way *prior* to examining the evidence. [80] Chairman Wood and Commissioner Brownell stated repeatedly in public, however, they were still examining the evidence and had not made a final decision. Moreover, at the time of the conference call, a massive record had already been compiled *and* reviewed by the Commission. The record, which started to be compiled as early as December 2001, included by the time of the conference call numerous pleadings, trial testimony, exhibits, initial and reply briefs, an ALJ initial

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[78] Wall Street representatives identified as participants and interviewed by the Inspector General were from Fitch Ratings, Lehman Brothers, Duquesne Capital Management, Merrill Lynch, Howard Weil (Legg Mason), Morgan Stanley, Moodys, Credit Lynonnais, S.A., Prudential Securities, Inc., Standard and Poor, Goldman Sachs, and Schwab Capital Markets.

[79] DOE/IG - 0610 June 2003, Results of the Inquiry p. 3.

[80] SCWC and Snohomish cite Antoniu v. SEC, 877 F.2d 721, 724 (8th Cir. 1989); McClure v. Indep. Sch. Dist. No. 16, 228 F.3d 1205 (10th Cir. 2000); Staton v. Mayes,552 F.2d 908 (10th Cir. 1977); and Cinderella Career & Finishing Sch., Inc. v. FTC, 425 F.2d 583 (D.C. Cir. 1970)

decision, and briefs on anu opposing exceptions. Indeed, the filing of briefs opposing exceptions normally closes the record in an adjudication. While the Commission took the extraordinary step here of holding an oral argument (subsecuent to the time of the conference call), that does not change the fact that the record was complete and reviewed, and the Commission was poised to act that day on the issues in the cases. To think that the Commissioners had not formed some preliminary opinions in these circumstances is simply unrealistic. Accordingly, the conference call at issue here reflected no prejudgment on the part of Chairman Wood and Commissioner Brownell.

86. Even assuming the conference call was a prohibited off-the-record communication, the violation has already been remedied. Recusal is not the remedy, disclosure is. Administrative proceedings blemished by ex parte communications may be remedied administratively by disclosing the communication and its contents.[81] In this regard, in the context of a Commission case, the court found that by placing summaries of meetings Commission officials held with industry officials, other parties were apprised "of any argument that may have been presented privately, thereby maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused.[82]

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[81] *See* 5 U.S.C. § 557(d)(1)(C)&(D); Prof'l Air Traffic Controllers Org. v. Fed. Labor Relations Auth., 685 F.2d 547, 565 n.36 (1982).

[82] *See* Louisiana Ass'n of Indep. Producers v. F.E.R.C., 958 F.2d 1101, 1112 (D.C. Cir. 1992)(Louisiana).

87. In addition, in *Louisiana*, the court made clear that recusal was not necessary or desirable even though there may have been *ex parte* communications.[83] Recusal here, therefore, would be an extraordinary and unwarranted remedy.[84] The court further explained,

> recusal would be required only if the communications posed a serious likelihood of affecting the agency's ability to act fairly and impartially in the matter before it. In resolving that issue, one must look to the nature of the communications and particularly to whether they contain factual matter or other information outside of the record, which the parties did not have an opportunity to rebut.[85]

88. As described above, the conference call contained no factual matter or other information outside the record, and even assuming it did, SCWC and Snohomish had ample chance to rebut it at the oral argument or by filing a response.

89. SCWC and Snohomish also argue on rehearing that the Commission's disclosure of the

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[83] *Id.* at 1112 (citing FTC v. Cement Inst., 333 U.S. 683, 702 (1948)("It is expected that administrative official will build up expertise through experience with recurring issues.") and Laird v. Tatum, 409 U.S. 824, 837 (1972)("Such expertise should not lightly be tossed aside.")).

[84] *See* Power Auth. of N.Y. v. F.E.R.C., 743 F.2d 93, 110 (2d Cir. 1984) ("The mere existence of such communications hardly requires a court or administrative body to disqualify itself.").

[85] *Id.* at 110.

conference call was not adequate for a prohibited off-the-record communication in that (1) it was not recorded, (2) roll call was not taken and the identity of the participants is not known with certainty, (3) separate summaries of the communication were not prepared by Chairman Wood and Commissioner Brownell, and Kevin Cadden is not eligible under the rules to write the summary, (4) the summary was not available within 14 days of the communication, and (5) the investigation of the call for this and other possible off-the-record communications was not sufficient. SCWC and Snohomish are wrong on all counts.

90. Even assuming the APA and Rule 2201 required disclosure of the conference call, the Commission plainly met the disclosure requirements. For this purpose, Rule 2201 mirrors the APA disclosure requirements at 5 U.S.C. § 557(d)(1)(C). It requires that any decisional employee who makes or receives a prohibited off-the-record communication will promptly submit to the Commission's Secretary that communication, if written, or a summary of the substance of that communication, if oral. *See* 18 C.F.R. § 385.2201(f)(2). Any party may file a response to the communication. *See* 18 C.F.R. § 385.2201(f)(3). The Secretary will then, not less than every 14 days, issue a public notice listing any prohibited off-the-record communications or summaries of the communication received by her office. *See* 18 C.F.R. § 385.2201(h)(1). That is exactly what happened here, albeit in response to SCWC and Snohomish's motion: a summary of the communication, to which these parties could have responded, was publicly noticed by the Secretary within moments of the

Commission's treatment of the conference call as if it were an off-the-record communication.

91. SCWC and Snohomish's attempt in effect to impose their own additional requirements on the Commission must be rebuffed. There is no requirement that the conference call had to be recorded or all of the participants identified. Nevertheless, Mr. Cadden contacted numerous invitees asking if they had recorded the conference call; no one had. The Commission also disclosed a list of invitees since the participants did not take roll call. More the point, SCWC and Snohomish's concerns about the identity of the outside participants are irrelevant. The communication is the target of the APA and Rule 2201, not the persons to whom the communication is made. Indeed, Rule 2201 prohibits certain off-the-record communications with *all* persons, not just parties or interested persons, outside the Commission. *See* 18 C.F.R. § 385.2201(b).

92. There is also no requirement that every Commission participant involved in an off-the-record communication file a separate summary. Mr. Cadden, who was present during the call, drafted the summary, and Chairman Wood and Commissioner Brownell reviewed and edited it. Contrary to SCWC and Snohomish's assertion, Mr. Cadden, Director of the Office of External Affairs, is a decisional employee and eligible under Rule 2201 to write the summary.[86] Along the same lines, Rule 2201 does not require multiple summaries, nor should it. Such

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[86] *See* Policy Statement on Separation of Functions, 101 F.E.R.C. ¶ 61,340, at 47 and 48.

duplicative effort would be administratively inefficient and burdensome.

93. There is likewise no requirement that a summary must be available within 14 days of the communication. Rule 2201 requires a Commission participant in a prohibited off-the-record communication to submit to the Secretary promptly that communication, if written, or a summary of the substance of that communication, if oral. *See* 18 C.F.R. § 385.2201(f)(2). Only then must she publish a notice. SCWC and Snohomish thus confuse the requirement of Rule 2201 that the Secretary release within 14 days of her receipt any such communications or summaries and the requirement that Commission participants in the communication promptly submit these items to the Secretary. Here, as noted, Mr. Cadden promptly submitted a summary of the substance of the communication in the conference call to the Secretary after the Commission chose to treat the call as if it involved an off-the-record communication. Within 14 days, in fact within hours, the Secretary released the summary received by her office.

94. As a final matter, neither the APA nor Rule 2201 requires an investigation.[87] As noted, however, the Office of the Inspector General for the

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[87] SCWC and Snohomish's reliance on Professional Air Traffic Controllers Organization v. FLRA, 672 F.2d 109 (D.C. Cir. 1982)(PATCO), is without merit. In PATCO, the court ordered an investigation because of an allegation that a well-known organized labor figure had attempted to influence the vote of one of the FLRA members. There is no allegation of such an attempt to influence here.

Department of Energy conducted a thorough investigation of the matter at the request of Senators Joseph Lieberman and Maria Cantwell. The Inspector General's report, which was issued on June 27, 2003, found that the Commission had not violated any procedural rules. Any further investigation would place a tremendous and unnecessary burden on the Commission, and effectively require the Commission to poll all of its employees.[88] Commission employees already have an affirmative obligation under Rule 2201 to report off-the-record communications should they occur. Similarly untenable is SCWC and Snohomish's request that invitees to the March 26 conference call be subpoenaed, required to state under oath whether they participated in the meeting or recorded the call, and required to provide their notes.[89]

Alleged Sunshine Act Violations

95. On July 28, 2003, Snohomish filed a supplemental request for rehearing alleging that the March 26 conference call violated the Sunshine Act, because no public notice was published and the meeting was not recorded.[90] Snohomish is wrong.

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[88] For like reasons, the Commission will not address or pursue further the allegations made by Morgan Stanley in its April 22, 2003 motion against Commissioner Massey who supposedly received ex parte communications about these contract cases from Senator Cantwell.

[89] In addition to the summary disclosed by the Commission, on June 3, 2003, in response to separate FOIA requests, the Commission released to the SCWC and Snohomish more than 70 documents related to the call.

[90] This request is untimely as a request for rehearing of the April 23 Order, and the movants have failed to preserve the

The Sunshine Act applies only to a "meeting of an agency."[91] Section 552b(a)(2) defines a Sunshine Act "meeting" as "the deliberations of at least the number of individualized agency members required to take action on behalf of the agency where such deliberations determine or result in the joint conduct or disposition of official agency business." [92] Consistent with this, the Commission's Sunshine Act regulations specify that "the deliberations of at least a quorum of the Commission" are required in order for the Sunshine Act to apply. *See* 18 C.F.R. § 375.202(a)(1). Under the governing statute and regulations, at least three members of the Commission are required to be present for a quorum to exist. Specifically, the Department of Energy Organization Act, 42 U.S.C. §§ 7101-7352, which established the Commission provides that for the Commission "a quorum for the transaction of business shall consist of at least three members present." [93] Because only two Commissioners (Chairman Wood and Commissioner Brownell) participated in the call, there was no quorum to constitute a Commission "meeting" subject to the Sunshine Act.

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issue for judicial review. *See* 16 U.S.C. § 8251 (a) and (b). Nevertheless, the Commission will address the allegations.

[91] *See* 5 U.S.C. § 552(b); 5 U.S.C. § 552 b(a)(2), FCC v. ITT Word Commc'ns, Inc., 466 U.S. 463, 469 (1984) ("None of the Sunshine Act's requirements is triggered, however, "unless the gathering in question is a 'meeting' of that agency.").

[92] Natural Resources Def. Council, Inc. v. NRC, 216 F.3d 1180, 1182 (D.C. Cir. 2000).

[93] 42 U.S.C. § 7171(e); *See* also 18 C.F.R. § 375.101(e) (defining a quorum of the Commission as consisting of "at least three members present").

96. Moreover, as discussed above, the conference call did not involve any "deliberations" that "determine or result in the joint conduct or disposition of official agency business." *See* 5 U.S.C. 552b(a)(2). The summary of the March 26 conference call confirms that the two commissioners merely expressed viewpoints that had already been discussed at the March 26 open meeting. Even if the Commissioners did express their views regarding this proceeding, no "official agency business" was disposed of or conducted during the conference call. Therefore, the Commission rejects Snohomish's allegation that the conference call violated the Sunshine Act.

The Commission orders:

(A) The Complainants' requests for rehearing of the June 26 Order are hereby denied for the reasons stated in the body of this order.

(B) The Respondents' request for clarification of the June 26 Order is hereby granted in part and denied in part for the reasons stated in the body of this order.

(C) SCWC and Snohomish's rehearing request of the April 23, 2003 Order is hereby denied for the reasons stated in the body of this order.

By the Commission.

(SEAL)

Commissioner Massey dissenting with a separate statement attached.
Commissioner Brownell concurring with separate statement attached.

s/ Linda Mity
Linda Mitry,
Acting Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Nevada Power Company
and Sierra Pacific Power Company

Docket Nos. EL02-28-00
EL02-28-005
EL02-33-004
v. EL02-33-005
EL02-38-004
EL02-38-005

Enron Power Marketing, Inc.
El Paso Merchant Energy
American Electric Power Services, Corp.

Nevada Power Company

Docket Nos. EL02-29-004
EL02-29-005
v. EL02-30-004
EL02-30-005
EL02-31-004
Reliant Energy Services EL02-31-005
Energy Marketing, L.P. EL02-32-004
Mirant Americas EL02-32-005
Calpine Energy Services EL02-34-004
Morgan Stanley Capital Group EL02-34-005
BP Energy Company EL02-39-004
Allegheny Energy EL02-39-005
Supply Company, L.L.C.

Southern California Water Company

Docket Nos. EL02-43-004
v. EL02-43-005

Mirant Americas Energy Marketing, L.P.

Public Utility District No. 1
Snohomish County, Washington

Docket Nos. EL02-56-004
v. EL02-56-005

Morgan Stanley Capital Group, Inc.

(Consolidated)

(Issued November 10, 2003)

MASSEY, Commissioner, *dissenting*:

I dissented from the underlying order and nothing in today's order persuades me to change my mind. The public interest requires that the contracts at issue be reformed.

For the reasons stated in my dissent in the underlying order, I dissent from today's order.

s/ William L. Massey
William L. Massey
Commissioner

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY
COMMISSION

Nevada Power Company
and Sierra Pacific Power Company

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Morgan Stanley Capital Group EL02-34-005
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Snohomish County, Washington

Docket Nos. EL02-56-004
v. EL02-56-005

Morgan Stanley Capital Group, Inc.

(Consolidated)

(Issued November 10, 2003)

Nora Mead BROWNELL, Commissioner
concurring:

1. I am writing separately to reiterate a concern I raised about the June 26 Order: the rationale for concluding that modification of the contracts is subject to the public interest standard of review. When these cases were set for hearing, I noted that existing judicial case law seemed to indicate that the public interest standard applied to all of these contracts based solely on the contracts' failure to explicitly reserve the buyers' right to seek unilateral changes under Section 206.[1] Nevertheless, I was

[1] Nev. Power Co. & Sierra Pac. Power Co. v. Duke Energy Trading & Mktg., L.L.C., 99 F.E.R.C. ¶ 61,047 (2002) (citing Texaco Inc. v. F.E.R.C., 148 F.3d 1091, 1096 (D.C. Cir. 1998) and Boston Edison Co. v. F.E.R.C., 233 F.3d 60, 67 (1st Cir. 2000)).

willing to set the issue for hearing so that the parties and the ALJ could have an opportunity to further explore whether my understanding of the case law was accurate. Three ALJs have now independently come to the same conclusion: judicial case law establishes that in the absence of clear contractual language allowing unilateral contract modification, the party seeking the change must meet the public interest standard.[2]

2. This order could have simply affirmed the ALJ's conclusion on this point and ended there the analysis of which standard to apply. That is what I am voting to do. Unfortunately, today's order fails to do so and instead bases the finding of the applicable standard on an analysis of the extrinsic evidence that parties did or did not present at hearing. By doing so, the order ignores the law. The *Mobile-Sierra* doctrine is not an invention of the FERC that we are free to mold as we wish; it is a directive from the Supreme Court. Moreover, the order misses an opportunity to provide clarity and certainty to all market participants and leaves open the possibility that the Commission may order unnecessary fact-finding on the parties' intent in future contract abrogation cases.

s/ Nora Mead Brownell
Nora Mead Brownell

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[2] Pub. Utils. Comm'n of Cal. v. Sellers of Long-Term Contracts to the Cal. Dep't of Water Resources, 102 F.E.R.C. ¶ 63,013 at P 28 (2003); Nev. Power Co. & Sierra Pac. Power Co. v. Duke Energy Trading & Mktg., L.L.C., 101 F.E.R.C. ¶ 63,031 at P 27 (2002); and PacifiCorp v. Reliant Energy Servs., Inc., 102 F.E.R.C. ¶ 63,030 at P 18 (2003).

APPENDIX T

Pertinent provisions of the Federal Power Act are codified at 16 U.S.C. § 791 *et seq.* as follows:

§ 824a. Interconnection and coordination of facilities; emergencies; transmission to foreign countries

(a) Regional districts; establishment; notice to State commissions

For the purpose of assuring an abundant supply of electric energy throughout the United States with the greatest possible economy and with regard to the proper utilization and conservation of natural resources, the Commission is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy, and it may at any time thereafter, upon its own motion or upon application, make such modifications thereof as in its judgment will promote the public interest. Each such district shall embrace an area which, in the judgment of the Commission, can economically be served by such interconnected and coordinated electric facilities. It shall be the duty of the Commission to promote and encourage such interconnection and coordination within each such district and between such districts. Before establishing any such district and fixing or modifying the boundaries thereof the Commission shall give notice to the State commission of each

State situated wholly or in part within such district, and shall afford each such State commission reasonable opportunity to present its views and recommendations, and shall receive and consider such views and recommendations.

(b) Sale or exchange of energy; establishing physical connections

Whenever the Commission, upon application of any State commission or of any person engaged in the transmission or sale of electric energy, and after notice to each State commission and public utility affected and after opportunity for hearing, finds such action necessary or appropriate in the public interest it may by order direct a public utility (if the Commission finds that no undue burden will be placed upon such public utility thereby) to establish physical connection of its transmission facilities with the facilities of one or more other persons engaged in the transmission or sale of electric energy, to sell energy to or exchange energy with such persons: Provided, That the Commission shall have no authority to compel the enlargement of generating facilities for such purposes, nor to compel such public utility to sell or exchange energy when to do so would impair its ability to render adequate service to its customers. The Commission may prescribe the terms and conditions of the arrangement to be made between the persons affected by any such order, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them.

(c) Temporary connection and exchange of facilities during emergency

During the continuance of any war in which the United States is engaged, or whenever the Commission determines that an emergency exists by reason of a sudden increase in the demand for electric energy, or a shortage of electric energy or of facilities for the generation or transmission of electric energy, or of fuel or water for generating facilities, or other causes, the Commission shall have authority, either upon its own motion or upon complaint, with or without notice, hearing, or report, to require by order such temporary connections of facilities and such generation, delivery, interchange, or transmission of electric energy as in its judgment will best meet the emergency and serve the public interest. If the parties affected by such order fail to agree upon the terms of any arrangement between them in carrying out such order, the Commission, after hearing held either before or after such order takes effect, may prescribe by supplemental order such terms as it finds to be just and reasonable, including the compensation or reimbursement which should be paid to or by any such party.

(d) Temporary connection during emergency by persons without jurisdiction of Commission

During the continuance of any emergency requiring immediate action, any person engaged in the transmission or sale of electric energy and not otherwise subject to the jurisdiction of the Commission may make such temporary connections with any public utility subject to the jurisdiction of the Commission or may construct such temporary

facilities for the transmission of electric energy in interstate commerce as may be necessary or appropriate to meet such emergency, and shall not become subject to the jurisdiction of the Commission by reason of such temporary connection or temporary construction: Provided, That such temporary connection shall be discontinued or such temporary construction removed or otherwise disposed of upon the termination of such emergency: Provided further, That upon approval of the Commission permanent connections for emergency use only may be made hereunder.

(e) Transmission of electric energy to foreign country

After six months from August 26, 1935, no person shall transmit any electric energy from the United States to a foreign country without first having secured an order of the Commission authorizing it to do so. The Commission shall issue such order upon application unless, after opportunity for hearing, it finds that the proposed transmission would impair the sufficiency of electric supply within the United States or would impede or tend to impede the coordination in the public interest of facilities subject to the jurisdiction of the Commission. The Commission may by its order grant such application in whole or in part, with such modifications and upon such terms and conditions as the Commission may find necessary or appropriate, and may from time to time, after opportunity for hearing and for good cause shown, make such supplemental orders in the premises as it may find necessary or appropriate.

(f) Transmission or sale at wholesale of electric energy; regulation

The ownership or operation of facilities for the transmission or sale at wholesale of electric energy which is (a) generated within a State and transmitted from that State across an international boundary and not thereafter transmitted into any other State, or (b) generated in a foreign country and transmitted across an international boundary into a State and not thereafter transmitted into any other State, shall not make a person a public utility subject to regulation as such under other provisions of this subchapter. The State within which any such facilities are located may regulate any such transaction insofar as such State regulation does not conflict with the exercise of the Commission's powers under or relating to subsection (e) of this section.

(g) Continuance of service

In order to insure continuity of service to customers of public utilities, the Commission shall require, by rule, each public utility to--

(1) report promptly to the Commission and any appropriate State regulatory authorities any anticipated shortage of electric energy or capacity which would affect such utility's capability of serving its wholesale customers,

(2) submit to the Commission, and to any appropriate State regulatory authority, and periodically revise, contingency plans respecting--

(A) shortages of electric energy or capacity, and

(B) circumstances which may result in such shortages, and

(3) accommodate any such shortages or circumstances in a manner which shall--

(A) give due consideration to the public health, safety, and welfare, and

(B) provide that all persons served directly or indirectly by such public utility will be treated, without undue prejudice or disadvantage.

§ 825*l*. Review of Orders

(a) Application for rehearing; time periods; modification of order.

Any person, electric utility, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this Act to which such person, electric utility, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any orders of the Commission shall be brought by any entity unless such entity shall have

made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b), the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this Act.

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for

rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

(c) Stay of Commission's order.

The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate

as a stay of the Commission's order.

§ 824v. Prohibition of energy market manipulation

(a) In general

It shall be unlawful for any entity (including an entity described in section 824(f) of this title), directly or indirectly, to use or employ, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 78j(b) of Title 15), in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of electric ratepayers.

(b) No private right of action

Nothing in this section shall be construed to create a private right of action.